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Quran & Capitalism:

Income Share Agreements under *Shari'ah*

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Rollins College

Spring 2017

In partial fulfillment of the requirements for the degree of

Honors Bachelor of Arts in International Business

## Table of Contents

<b>Introduction.....</b>	<b>2</b>
<b>Motivation.....</b>	<b>7</b>
<b>The State of Higher Education .....</b>	<b>9</b>
How to Finance College.....	19
The Success of Income Contingent Repayment .....	25
<b>Income Share Agreements .....</b>	<b>28</b>
Informal Income Share Agreements.....	28
Formal Income Share Agreements .....	29
Income Share Agreement Examples.....	32
The Nature of Income Share Agreements.....	38
Income Share Agreement vs. Loan.....	42
<b>Shari'ah Values .....</b>	<b>46</b>
Shari'ah's Linguistic Foundation .....	49
Shari'ah Values .....	52
Fiqh .....	57
Shari'ah Protections.....	69
Shari'ah Foundational Value.....	71
Maslahah: Public Good .....	74
<b>Shari'ah Compliance of Income Share Agreements .....</b>	<b>76</b>
Islamic Finance Analogue .....	77
Islamic Contracts.....	78
Murabaha .....	82
Ijarah.....	83
Musharakah.....	84
Sukuk .....	86
Mudarabah .....	88
Corruption by Gharar, Maisir, and Riba.....	89
Gharar .....	90
Maisir .....	94
Riba .....	96
Income Share Agreements as a Tool of Public Good .....	100
<b>Conclusion .....</b>	<b>103</b>
<b>Appendix .....</b>	<b>106</b>
<b>Works Cited .....</b>	<b>108</b>

## Qur'an & Capitalism: Income Share Agreements under Shari'ah

*"The causes which destroyed the ancient republics were numerous; but in Rome, one principal cause was the vast inequality of fortunes" – Noah Webster*

### Introduction

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The ills of income inequality are felt everyday by working mothers and struggling fathers. Their children, seeking education and professional experience, face the dual-pronged paradox of stagnating wages<sup>1</sup> whose only remedy, education, is encumbered by skyrocketing costs of attainment.<sup>2</sup> Such an unsustainable model results in greater wealth inequality which, as Webster points out above, has led to the demise of once great republics. A change in contemporary educational financing must be enacted and a potential agent for that change is the development of income share agreements.

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<sup>1</sup> Minimum wages peaked in 1968 and have steadily lost their purchasing power. Source: Drew Desilver, "5 Facts about the Minimum Wage," *Pew Research Center*, 2016, <http://www.pewresearch.org/fact-tank/2017/01/04/5-facts-about-the-minimum-wage/>.

<sup>2</sup> In the decade between 2003 and 2013, public education costs increased 34% while private education costs increased 25%. Wages of paying parents and working students, obviously, could not keep up. Source: US Department of Education and National Center for Education Statistics, "Tuition Costs of College and Universities" (Washington DC: National Center for Education Statistics, 2016), <https://nces.ed.gov/fastfacts/display.asp?id=76>.

Despite the ills of contemporary applications of capitalism in educational financing, capitalism has succeeded in creating the richest nations in modern history.<sup>3</sup> Just two centuries ago, 94% of the world's population lived in poverty, a metric defined by earning income of less than \$2.00 per day.<sup>4</sup> Such staggering global poverty has fortunately reversed course with only 9.6% of the current global population at poverty-level subsistence.<sup>5</sup> This advancement in individual wealth is a result of the rise in education, measured by literacy, over the same two centuries.<sup>6</sup> This presents a conundrum. On one hand, the capitalist system of today has created a vastly better world than that of before, especially when measured in terms of GDP per person,<sup>7</sup> however, this system is on the other hand compelling the world's youth to a future of poverty with increasingly impossible barriers of entry for the only panacea to such poverty: educational attainment.

Attainment of higher education is typically financed through the following means: bank debt, government student loans, government service for eventual loan forgiveness, scholarships and grants, and an endless cycle of debt financing and refinancing are available. Each of these, however, have been available for decades and

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<sup>3</sup> Max Roser and Esteban Ortiz-Ospina, "World Poverty," *Our World in Data*, 2016, <https://ourworldindata.org/world-poverty/#empirical-view>.

<sup>4</sup> Ibid.

<sup>5</sup> Ibid.

<sup>6</sup> Max Roser, "A History of Global Living Conditions in 5 Charts," *Our World in Data*, 2017, <https://ourworldindata.org/a-history-of-global-living-conditions-in-5-charts/>.

<sup>7</sup> James Pethokoukis, "The Most Important Economic Chart in Western Civilization - and How It Happened," *American Enterprise Institute*, 2013, <https://www.aei.org/publication/the-most-important-economic-chart-in-western-civilization-and-how-it-happened/>.

still, college continues to become less affordable. Numerous solutions have been proposed to abate the education-income obstacles so many modern youth face stemming from systemic income inequality. These range from policies as extreme as a universal basic income<sup>8</sup> to the more mundane policies espoused by populist political candidates<sup>9</sup> such as tuition-free public colleges and universities.<sup>10</sup> Unfortunately, these policies face an uphill battle in Congress and the entire weight of corporate-, capitalist-, and investor-America. Universal basic income or tuition-free universities ostensibly address the education-income dilemma by providing, respectively, a guaranteed income and an education at no cost. But the plutocratic members of the corporate and capitalist America have little incentive to permit such revolutionary methods of wealth redistribution. There is a misalignment in goals between capitalist elites and those to whom their capital serves and from whom it is derived and it is important to identify and implement as many solutions to this crisis as possible.

Income share agreements provide a potential solution. Income share agreements are contracts between an investing party and a student wherein the investing party agrees to provide capital to fund a student's education in return for a percentage of a student's income over a predetermined term. This allows students to

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<sup>8</sup> Charles Murray, "A Guaranteed Income for Every American," *Wall Street Journal*, 2016, <http://www.wsj.com/articles/a-guaranteed-income-for-every-american-1464969586>.

<sup>9</sup> Senator Bernie Sanders (I-VT), a candidate in the 2016 Democratic primaries, most fully embraced this policy.

<sup>10</sup> Friends of Bernie Sanders, "On the Issues: It's Time to Make College Tuition Free and Debt Free," *Friends of Bernie Sanders*, 2016, <https://berniesanders.com/issues/its-time-to-make-college-tuition-free-and-debt-free/>.

immediately access their potential future earnings to fund their current education requirements.

Amid a growing student debt crisis is the growth of *shari'ah*-compliant financial tools available to investors. *Shari'ah*, an Islamic framework for morality based on the Quran and the sayings and actions of Prophet Muhammad, contains structures permitting and encouraging commercial success. To finance commercial endeavors while remaining in compliance with *Shari'ah* requires the avoidance of usury according to most interpretations of Quranic scripture. Ostensibly, loans with interest are thus unacceptable. *Shari'ah* also demands avoidance of several other corruptors of Islamic contracts, including *gharar* (deceptive practices) and *maisir* (get rich quick schemes). To satisfy commercial and religious needs, Islamic finance scholars have developed numerous innovations in financial products to provide access to capital while simultaneously avoiding interest. These tools allow Muslim investors to engage commercially in a way that adheres to *shari'ah's* overarching principles of justice, equity, and community and its ultimate goal of engendering greater public good.

Any financial tool that avoids usury is of interest to Muslim financiers and investors. While the Muslim community in the United States is small (at less than 1% of the total US population) and of that community, those interested exclusively in Islamic financial products is likely even smaller, the international Muslim community is significant and their interest in Islamic financial products is growing.<sup>11</sup> Muslim investors

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<sup>11</sup> Besheer Mohamed, "A New Estimate of the U.S. Muslim Population," *PewResearchCenter*, 2016, <http://www.pewresearch.org/fact-tank/2016/01/06/a-new-estimate-of-the-u-s-muslim-population/>.

internationally and especially those of the oil rich Gulf, will want to invest their capital where it is most productive while also observing *shari'ah* values. As these countries shift their economies away from petrol, their central banks and individual investors will increase international investment. The United States economy, especially during contemporary global economic uncertainty, is considered a safe haven asset destination with respect to emerging markets. Yet, within the United States, only 25 Islamic banks exist<sup>12</sup> and none of the major US financial institutions, like J.P. Morgan, Goldman Sachs, and Bank of America offer domestic *shari'ah* compliant financial products and of those that do, none list them on their American websites.<sup>13</sup> The United States market is ripe with opportunity for Islamic banking serving both domestic and international clients. Across the pond in the United Kingdom, with approximately the same number of Muslims as in the United States, over \$19 billion in Islamic banking assets is split between 20 Islamic financial institutions.<sup>14</sup> The vastness of educational financing in the United States hinges on the utilization of interest for American financial institutions. This excludes any Muslim financier intending on investing in usury-free financial instruments. As income share agreements are a usury-free financial instrument, they have tremendous potential to attract Muslim investors.

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<sup>12</sup> Abdi Shayesteh, "Islamic Banks in the United States: Breaking Through the Barriers," *NewHorizon*, no. 171 (2009), [http://www.kslaw.com/Library/publication/6-09 New Horizon Shayesteh.pdf](http://www.kslaw.com/Library/publication/6-09%20New%20Horizon%20Shayesteh.pdf).

<sup>13</sup> Mohammed Kamil Sheikh, "Top 5 Islamic Banks in USA," *Ideal Muslim*, 2013, <http://www.idealmuslim.com/top-5-islamic-banks-in-usa/>.

<sup>14</sup> Renee Haltom, "Islamic Banking, American Regulation," *Federal Reserve Bank of Richmond*, 2014, [https://www.richmondfed.org/publications/research/econ\\_focus/2014/q2/feature1](https://www.richmondfed.org/publications/research/econ_focus/2014/q2/feature1).



This paper intends to analyze the degree to which Income Share Agreements as a tool for student finance are compliant with *shari'ah* principles and goals. This paper seeks an answer to the following question: Are income share agreements compliant with *shari'ah* law?

Addressing this inquiry begins with an overview of income share agreements and continues with an inquiry into *shari'ah*. These two topics have never been studied together. Following the overview of income share agreements and *shari'ah* is an analysis of the degree to which such financing is compliant with Islamic jurisprudence and what conditions are required to facilitate such compliance. As interest in *shari'ah* compliant finance grows alongside students' need for greater access to capital, the possibility and necessity of determining the compliance of Income Share Agreements with *shari'ah* grows. This thesis posits that income share agreements are indeed compliant with *shari'ah* and already find an Islamic finance analogue in *mudarabah* (investment partnership) contracts. Their avoidance of the three corruptors of Islamic finance, usury; deception; and gambling and their engendering of public good and minimization of public harm classifies income share agreements as *shari'ah* compliant.

## Motivation

The author's interest in income share agreements stems from, for years, standing in awe of the fantastic accomplishments and potential of his peers. On countless occasions, the author has witnessed his most high-potential friends make academic and professional decisions on the basis of insufficient financing instead of the

reality of their potential. Potential future doctors, lawyers, scientists, statesmen, and many more eschewed an Ivy League or top tier education in favor of community college, despite having those prestigious acceptance letters in hand, because they feared they could not make the financial commitment. This portends a less success future to those students and the international community. The author fully believes that each individual is morally obligated to seek opportunity to maximize their potential and believes that income share agreements are an opportunity that should be open to high-potential students.

As an American student with Muslim, Arab, and Latin American roots, the author knew from a young age that one day, the parent-child roles would be switched. As his parents grow older and older, the reality of the author becoming his parents' caretaker grows. Such a reversal is inherent to Arab and Latino culture and in both exists a social contract resembling an income share agreement. In exchange for raising and ceaselessly providing for the author, the author will in return happily dedicate a portion of his earnings to his parents' well-being. The author grew up his whole life understanding his position in an informal income share agreement. The interest-free nature of income share agreements seemed obviously correlated to Islamic banking and yet, none before had drawn that connection. Thus, in the spirit of academic inquiry and conquest, the author sought out to draw the link between the intimate reality of his home culture and the growing sector of global finance that is *shari'ah*-compliant finance.

## The State of Higher Education

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Higher education in the United States remained, until World War II, exclusive to the uppermost strata of society, accessed by few and required, not for career advancement, but as part of admission into the social bourgeoisie. Colonial American colleges enrolled fewer than one hundred students and even fewer completed their degrees.<sup>15</sup> Literacy rates were low, with only sixty percent of the most potentially literate portions of the population, white males, able to read documents and sign their name.<sup>16</sup> Such tremendously low higher educational attainment rates continued well into the 20<sup>th</sup> century. By 1940, only six percent of white males, four percent of white females, and less than two percent of all minorities, male and female alike, completed a four-year college degree.<sup>17</sup> Despite the provision and popularity of free public primary and secondary education by the 20<sup>th</sup> century, barely over half of Americans in 1940 completed high school.<sup>18</sup>

Between the colonial era and the 20<sup>th</sup> century, there was little need for higher education in the United States. The United States economy specialized in agriculture, a

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<sup>15</sup> John R. Thelin, Jason R. Edwards, and Eric Moyer, "Higher Education in the United States - Historical Development, System," *StateUniversity*, 2013, <http://education.stateuniversity.com/pages/2044/Higher-Education-in-United-States.html>.

<sup>16</sup> Jack Lynch, "Every Man Able to Read," *Colonial Williamsburg Journal*, 2011, <https://www.history.org/Foundation/journal/Winter11/literacy.cfm>.

<sup>17</sup> Thomas D Snyder, "120 Years of American Education: A Statistical Portrait" (Washington DC, 1993), 7-8, <https://nces.ed.gov/pubs93/93442.pdf>.

<sup>18</sup> Stephen Rose, "The Value of a College Degree," *The Magazine of Higher Learning* 45, no. 6 (2013): 24–32, [https://cew.georgetown.edu/wp-content/uploads/2013/11/TVOACD.SR\\_.pdf](https://cew.georgetown.edu/wp-content/uploads/2013/11/TVOACD.SR_.pdf).

sector consuming 80% of its total labor force in 1820. This figure decreasing to a still significant 20% by 1940.<sup>19</sup> Agriculture, of course, requires only the most basic of literacy, if any at all, for a laborer to be successful. As agricultural prowess gave way to manufacturing might, the US labor force still did not demand significant levels of education. An abundance of high paying factory jobs during the post-war manufacturing boom of the 1950s meant that the marginal benefit of higher education was rather modest. A male laborer over the age of 25 with a four-year high school degree, in 1958 could expect to earn only thirty percent less than his college educated counterpart. This gulf, while ostensibly significant, does not demonstrate that the cost of living in 1958 was sufficiently satisfied by the average 1958 wage of \$5,257; to live a middle class lifestyle, you did not need higher education.<sup>20,21,22</sup> Throughout the country, there was insufficient need for a large population of college educated laborers.

The United States as a service based economy requiring laborers with greater education is a relatively recent phenomenon. Fisher, Clark, and Fourastié each contributed to the three-sector-theory which divides economies into the three sectors of primary, secondary, and tertiary. While each scholar defined these sectors differently, according to economic activity for Clark; income and consumption for Fisher; and

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<sup>19</sup> Richard Sullivan, "Trends in the Agricultural Labor Force," in *The State of Humanity*, ed. Julian Simon (Hoboken: Wiley, 1996).

<sup>20</sup> Snyder, "120 Years of American Education: A Statistical Portrait", 22.

<sup>21</sup> Rent, in 1958, can be interpolated to approximately \$55.62 according to the U.S. Housing Census, consuming only 12.7% of the average monthly income of a male at least 25 years of age with only a high school diploma.

<sup>22</sup> U.S. Census Bureau, "Historical Census of Housing Tables - Gross Rents" (Washington DC, 2011), <https://www.census.gov/hhes/www/housing/census/historic/grossrents.html>.

productivity growth for Fourastié,<sup>23</sup> the combined theory coalesces into the following, according to Goodwin et al.:

**1. Primary Sector:**

- a. Economic activities concerning the harvest and extraction of raw materials sold, not to consumers, but to manufacturers as inputs.
- b. Examples include agriculture, mining, and fishing.<sup>24</sup>

**2. Secondary Sector:**

- a. Economic activities processing, refining, and converting raw materials into consumer goods.
- b. Examples include manufacturing, construction, and utilities.<sup>25</sup>

**3. Tertiary Sector:**

- a. Economic activities providing services to consumers instead of tangible goods.
- b. Examples include tourism, financial services, and IT services.<sup>26</sup>

This distinction is not necessarily sequential, i.e., economies do not advance from primary to secondary and terminate in tertiary, but rather, countries are understood to devote greater shares of their economy and labor force first to agriculture, then

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<sup>23</sup> Jean-Claude. Delaunay and Jean. Gadrey, "The Tertiary Sector and Post-Industrial Society," in *Services in Economic Thought : Three Centuries of Debate*, ed. Aart Heesterman (New York: Springer Science & Business Media, 2012), 75–79.

<sup>24</sup> Neva Goodwin et al., "The Structure of the United States Economy," in *Macroeconomics in Context*, 2nd ed. (New York: Routledge, 2015), 152–78, [http://www.ase.tufts.edu/gdae/pubs/te/mac/MAC\\_8\\_US\\_Economy\\_Aug\\_16\\_06.pdf](http://www.ase.tufts.edu/gdae/pubs/te/mac/MAC_8_US_Economy_Aug_16_06.pdf).

<sup>25</sup> Ibid.

<sup>26</sup> Ibid.

manufacturing, and finally to the service sector. As a share of GDP, the tertiary sector in the United States has always provided the greatest contribution, just under 60% in 1870, relative to the contributions of 22% for the primary sector and 19% for secondary sector.<sup>27</sup> Their relative shares began to shift soon after the 1870s with the secondary sector eclipsing the primary sector by 1890 and growing while the share of the economy devoted to the tertiary sector remained relatively constant.<sup>28</sup> From approximately 1930 to 1970, the secondary sector consumed an even greater share of GDP while the primary sector shrunk and the tertiary sector remained stagnant. However, as the percent of GDP devoted to manufacturing and agriculture eroded, the dominance of the tertiary sector increased.<sup>29</sup>

A similar narrative of the robust agricultural sector losing ground to the manufacturing sector, which then ceded dominance to the service economy, exists with United States labor force allocation. In 1900, the largest proportion of US laborers worked on farms at 37.6%, relative to 26.6% for white collar and service workers and 35.9% for manual workers.<sup>30</sup> Farm and manual labor does not require a college degree. By 1970, white collar and service workers made up 60.6% of the US labor force relative to the 35.3% working in manual labor and the 3.9% working as farm workers.<sup>31</sup> The relative declines of manual laborers and farm workers, with respect to white collar and

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<sup>27</sup> Ibid.

<sup>28</sup> Ibid.

<sup>29</sup> Ibid.

<sup>30</sup> Zoltan Kenessey, "The Primary, Secondary, Tertiary and Quaternary Sectors of the Economy," *Journal of the International Association for Research in Income and Wealth* 33, no. 4 (1987): 359–85, <http://www.roiw.org/1987/359.pdf>.

<sup>31</sup> Ibid.

service workers, has continued in earnest since then and as of 2009, nearly 80% of the US labor market is dedicated solely to the provision of services.<sup>32</sup>

This shift in the US labor market according to Bell, came because of a “secret mastered by modern Western society: productivity.”<sup>33</sup> Whereas societal advancement before came through accumulation of other’s wealth through war, pillage, and conquest, the West now developed an ability to “get more with less effort or less cost.”<sup>34</sup> This view of productivity, sans an overtly western-centric point of view, concurs with Turner and Bedore who noted that “the essential difference between rich and poor nations is the percentage between the purchase price of an ounce of raw cocoa in West Africa and the selling price of a Hershey bar in New York.”<sup>35</sup> Turner and Bedore’s example illustrates the significant value added to the refinement of a product from a raw material into a finished good. Doing so is a step in the process of maximizing productivity. This maximization of productivity catalyzed the West’s rise to economic dominance and its entrance into a “post-industrial society” according to Touraine.<sup>36</sup> Turner and Bedore neglect to point out, however, that the greatest and most efficient

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<sup>32</sup> Central Intelligence Agency, “United States,” *The World Factbook*, 2015, <https://www.cia.gov/library/publications/the-world-factbook/fields/2048.html>.

<sup>33</sup> Daniel Bell, “The Coming of Post-Industrial Society,” *Business and Society Review/Innovation* 1 (1974), [https://www.os3.nl/\\_media/2011-2012/daniel\\_bell\\_-\\_the\\_coming\\_of\\_post-industrial\\_society.pdf](https://www.os3.nl/_media/2011-2012/daniel_bell_-_the_coming_of_post-industrial_society.pdf).

<sup>34</sup> Ibid.

<sup>35</sup> Louis Turner and James Bedore, “The Trade Politics of Middle Eastern Industrialization,” *Foreign Affairs* 57, no. 2 (1978): 306–22, <https://www.foreignaffairs.com/articles/iran/1978-12-01/trade-politics-middle-eastern-industrialization>.

<sup>36</sup> Alain Touraine, *The Post-Industrial Society*, ed. Leonard F. X. Mayhew (New York: Random House, 1971), <http://autonomousuniversity.org/sites/default/files/Touraine-Alain-Post-Industrial-Society.pdf>.

value added to a Hershey bar is not so much its transformation from a cocoa bean to a chocolate bar (this has been done for centuries), but the intellectual capital required to package, market, and distribute said bar in addition to the engineering and scientific expertise necessary to develop the most suitable chemical composition of the bar. To accomplish these processes requires no machine, but rather, an educated and creative individual who can think, innovate, organize, contextualize, and implement. In light of this man-over-machine force for productivity, Bell asserts that “modern industrial society is a product of two ‘new men,’ the engineer and the economist, and of the concept which unites the two – the concept of efficiency.”<sup>37</sup> The engineer, designing machinery and situating it within a factory, along with the economist who calculates costs, prices, and labor demands, are united by an adoration for efficiency and it is the demand for intellectuals able to effect efficiency who truly advance the post-industrial economy.<sup>38</sup>

These engineers and economists, *efficientists*<sup>39</sup> in their own right, are products of higher education and are in demand because of their ability to organize labor and processes such that a maximal value can be extracted from a process. Wages are thus highly correlated with higher education. The differential between educated and uneducated laborers, once relatively small in the 1950s, widened to a 125% advantage

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<sup>37</sup> Bell, “The Coming of Post-Industrial Society.”

<sup>38</sup> Ibid.

<sup>39</sup> Individuals pushing for efficiency.



by 2000.<sup>40</sup> This gap widens as the level of education increases, with a bachelor's degree commanding a significant wage premium over a high school diploma and a professional degree easily exceeding the weekly median wage of a bachelor's degree.<sup>41</sup> Even among genetically identical twins, this trend is present with "an additional year of schooling increasing wages by 12-16%."<sup>42</sup> Considering the relative stagnation or decline of wages since 1979, despite real GDP growth of 149% and net productivity growth of 64%, the necessity of a college degree has become ever more prescient.<sup>43</sup> The American worker, in constant 2014 dollars, made more money in January 1973 than they do now, while costs of living have continued their steady march upward.<sup>44</sup>

For the contemporary American to best ensure economic success, insulation from the two-pronged stab of stagnating wages and increased cost, and entrance into the middle class, a college degree is necessary and is in many ways a rational financial decision.<sup>45</sup> For decades, the lifetime present value of a college degree (even after

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<sup>40</sup> Francisco J Buera and Joseph P Kaboski, "The Rise of the Service Economy," *American Economic Review* 102 (2012): 2540–69, [http://www3.nd.edu/~jkaboski/BK\\_AER\\_Final.pdf](http://www3.nd.edu/~jkaboski/BK_AER_Final.pdf).

<sup>41</sup> Bureau of Labor Statistics, "Earnings and Unemployment Rates by Educational Attainment," *Bureau of Labor Statistics*, 2016, [https://www.bls.gov/emp/ep\\_chart\\_001.htm](https://www.bls.gov/emp/ep_chart_001.htm).

<sup>42</sup> Orley Ashenfelter and Alan Krueger, "Estimates of the Economic Return to Schooling from a New Sample of Twins," *American Economic Review* 84, no. 5 (1994): 1157–73, <http://www.uh.edu/~adkugler/Ashenfelter&Krueger.pdf>.

<sup>43</sup> Elise Gould, "2014 Continues a 35-Year Trend of Broad-Based Wage Stagnation" (Washington DC, 2015), <http://www.epi.org/files/pdf/stagnant-wages-in-2014.pdf>.

<sup>44</sup> Drew DeSilver, "For Most Workers, Real Wages Have Barely Budged for Decades," *PewResearchCenter*, 2014, <http://www.pewresearch.org/fact-tank/2014/10/09/for-most-workers-real-wages-have-barely-budged-for-decades/>.

<sup>45</sup> David Leonhardt, "Is College Worth It? Clearly, New Data Say," *New York Times*, 2014, [http://www.nytimes.com/2014/05/27/upshot/is-college-worth-it-clearly-new-data-say.html?\\_r=0](http://www.nytimes.com/2014/05/27/upshot/is-college-worth-it-clearly-new-data-say.html?_r=0).

subtracting costs for tuition) has increased, from \$213,000 in 1965 to \$590,000 in 2010.<sup>46</sup> As each year passes, wages for college graduates increase at a greater rate than those for non-college graduates. Between 2014 and 2015, average wages for college graduates increased 5.2%<sup>47</sup> and nearly half of employers in 2016 indicated they will increase wages for their next round of graduate hires.<sup>48</sup> By many measures, attainment of a college education unlocks a tremendous amount of earning potential for students.

If college is the most efficient ticket to economic opportunity promised by nearly all data, then barriers to entry must be lowered as much as possible; this, however, is not necessarily the case. The most formidable barrier to attainment of a college degree is its sticker price, namely, tuition. According to the US Department of Education, between 1984 and 2014, a span of thirty years, the cost of a four-year degree has more than doubled, from \$11,548 to \$25,409 (in constant 2014 dollars), a doubling that has occurred among private and public universities alike.<sup>49</sup> Per the College Board, this doubling is also present when including fees, room, and board with cost of tuition.<sup>50</sup> For

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<sup>46</sup> Peter Dizikes, "Q&A: David Autor on Inequality among the '99 Percent,'" *MIT News*, 2014, <http://news.mit.edu/2014/qa-david-autor-inequality-among-99-percent-0522>.

<sup>47</sup> National Association of Colleges and Employers, "Average Starting Salary for Class of 2015 Climbs 5.2 Percent" (Bethlehem, 2015), <http://www.nacweb.org/s11182015/starting-salary-class-2015.aspx>.

<sup>48</sup> Phil Gardner and Andy Henion, "Starting Salaries Strong for College Graduates," *Michigan State University*, 2016, <http://msutoday.msu.edu/news/2016/starting-salaries-strong-for-college-graduates/>.

<sup>49</sup> US Department of Education and National Center for Education Statistics, "Tuition Costs of College and Universities."

<sup>50</sup> The College Board, "Tuition and Fees and Room and Board over Time, 1976-77 to 2016-17, Selected Years," *The College Board*, 2017, [https://trends.collegeboard.org/college-pricing/figures-tables/tuition-and-fees-and-room-and-board-over-time-1976-77\\_2016-17-selected-years](https://trends.collegeboard.org/college-pricing/figures-tables/tuition-and-fees-and-room-and-board-over-time-1976-77_2016-17-selected-years).

four-year private nonprofit institutions, the 2016-2017 school year costs 273% of the cost of an equivalent institution in 1981; for public colleges 2016-2017 costs are 266% their 1981 equivalents.<sup>51</sup> Using the College Board's data, if private institutions had tracked inflation, the current cost of tuition, fees, room, and board per year would be \$16,630 and \$7,540 for public institutions, not \$45,370 and \$20,090 respectively.<sup>52</sup> Over time, as a result of inflation, increased wealth, scarcity, abundance, and a whole host of other factors, the products we purchase become more expensive. However, real wages, as indicated before, have certainly not doubled within these time frames and have in fact stagnated. This means that the relative cost of a college education, i.e. its slice of a family's budget pie, has grown and now demands much more of a family budget than it once did. This relative growth in the cost of college, especially with respect to stagnating wages, makes attendance of college even more of a luxury than it was in the past.

College is particularly important for poor students or students from poor families. There exists a certain "stickiness"<sup>53</sup> associated with socioeconomic status such that being born into a wealthy family positively influences the degree to which one remains in that upper bracket, no matter whether one attains higher education.<sup>54</sup>

Overtime, this socioeconomic stickiness has become more corrosive and contributed to

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<sup>51</sup> Ibid.

<sup>52</sup> Ibid.

<sup>53</sup> This stickiness is most pronounced at the ends of the economic pendulum, with poorer students remaining in their diminished positions and wealthier students remaining in that privileged pool.

<sup>54</sup> Julia B Isaacs, Isabel V Sawhill, and Ron Haskins, "Getting Ahead or Losing Ground: Economic Mobility in America" (Washington D.C., 2008), [http://www.pewtrusts.org/~media/legacy/uploadedfiles/wwwpewtrustsorg/reports/economic\\_mobility/economicmobilityinamericafullpdf.pdf](http://www.pewtrusts.org/~media/legacy/uploadedfiles/wwwpewtrustsorg/reports/economic_mobility/economicmobilityinamericafullpdf.pdf).

a phenomena wherein completion of a degree now is much more correlated with growing up in a wealthier household than it did forty years ago.<sup>55</sup> Of those who complete their degrees, more than half hail from households in the upper quintile while only ten percent of degrees go to those in the bottom 25%.<sup>56, 57</sup>

To be poor is to be disadvantaged in one's immediate ability to satisfy daily needs and one's long term ability to attain the tools necessary to improving one's stature in life. Frankly, poverty is hard and the difficulty associated with affording college is one with which even Scandinavian and European states struggle. Pfeffer and Hällsten analyzed the United States, Germany, and Sweden and concluded that even among welfare states, nothing "provides a functional equivalent to the insurance against adverse outcomes afforded by parental wealth" and that parental wealth is substantially associated, across all three countries, with "children's educational success and social mobility."<sup>58</sup> Isaacs, Sawhill, and Haskins are in accord with this perspective, arguing that "family background plays a strong role in upward relative mobility

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<sup>55</sup> The Pell Institute and University of Pennsylvania Alliance for Higher Education and Democracy, "Indicators of Higher Education Equity in the United States" (Philadelphia, 2016), [http://www.pellinstitute.org/downloads/publications-Indicators\\_of\\_Higher\\_Education\\_Equity\\_in\\_the\\_US\\_2016\\_Historical\\_Trend\\_Report.pdf](http://www.pellinstitute.org/downloads/publications-Indicators_of_Higher_Education_Equity_in_the_US_2016_Historical_Trend_Report.pdf).

<sup>56</sup> Ibid.

<sup>57</sup> The upper quintile defined as having a family income of at least \$116,000 in 2014 and the lower quintile is defined by families with less than \$35,000 in annual income that same year. These definitions are from The Pell Institute and the University of Pennsylvania Alliance for Higher Education.

<sup>58</sup> Fabian T Pfeffer and Martin Hällsten, "Mobility Regimes and Parental Wealth: The United States, Germany, and Sweden in Comparison" (Ann Arbor, 2012), <http://fabianpfeffer.com/wp-content/uploads/PfefferHaellsten2012.pdf>.

regardless of college education.”<sup>59</sup> These three go on to observe, quite poignantly, that “23 percent of those born into the top quintile that do not get a degree stay at the top as adults” and that if they are white, they are more likely to pass this economic advantage to their children.<sup>60</sup> Despite this dour outlook and despite their observation that “the rate of relative [economic] mobility hasn’t changed much since 1970,” adult children, regardless of parental income, “are more likely to surpass their parents’ income in absolute terms if they have a college degree” and, if they have a college degree, are “more likely to reach the top quintile.”<sup>61</sup>

### ***How to Finance College***

Thus far, it has been noted simply that college is an indispensable tool for economic advancement. However, students face a bevy of barriers inhibiting attainment of a degree. There are the exploding direct costs of college which consumes a greater share of an individual’s or a family’s budget. This is exacerbated by stagnating wages over the past four decades which has led to college becoming even more of a luxury for the wealthy, much as it was during the colonial era. As college is integral to economic mobility and its attainment has become drastically reduced for poorer Americans, wealth inequality in the United States has grown and if there is not a change to the college-funding paradox, inequality is likely to become worse.

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<sup>59</sup> Isaacs, Sawhill, and Haskins, “Getting Ahead or Losing Ground: Economic Mobility in America.”

<sup>60</sup> Ibid.

<sup>61</sup> Ibid.

This leads to a fundamental question: how can college education be financed to promote equitable access to higher education? Currently, there exist several options. A student's education can be funded by their families, savings, or entrepreneurial ventures. Students can also seek funding from their employers and they can solicit gifts, donations, and scholarships but ultimately, most students unable to pay for college on their own turn to debt financing.<sup>62</sup> Within each of these, at a minimum, are serious problems relating to scope and feasibility which limit their lucrativeness.

The expectation that all college education can be financed by one's family is almost universally fallacious.<sup>63</sup> As has been noted, the costs for higher education have increased significantly without a compensatory increase in overall wages such that only the families at the upper end of US income brackets can afford higher education. Obviously, not all families possess sufficient financial capital to fund their child's higher education aspirations. Students entering college frequently do not have sufficient savings to pay for their education, thus the financing burden disproportionately falls on students' parents, with 29% of students funding college thanks to their parents' income and savings.<sup>64</sup> Parents dipping into income and savings, however, are placing themselves

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<sup>62</sup> The Institute for College Access & Success, "Quick Facts About Student Debt" (Oakland, 2014), [http://ticas.org/sites/default/files/pub\\_files/Debt\\_Facts\\_and\\_Sources.pdf](http://ticas.org/sites/default/files/pub_files/Debt_Facts_and_Sources.pdf).

<sup>63</sup> It is important to note that the author believes that community college is an underutilized tool in empowering undergraduate students to attain higher education. For the purpose of concision, this inquiry focuses on four year public and private higher education institutions.

<sup>64</sup> Sallie Mae and Ipsos Public Affairs, "How America Pays for College: 2016" (Neward, 2016), [http://news.salliemae.com/files/doc\\_library/file/HowAmericaPaysforCollege2016FNL.pdf](http://news.salliemae.com/files/doc_library/file/HowAmericaPaysforCollege2016FNL.pdf).

in a significantly risky position as each dollar contributed to their child's education is one not allocated to their own retirement savings. This presents a particularly poor negative feedback loop for a family's finances as students then may be compelled to finance their parents' retirement, harming their own future ability to fund retirement and portending increasing government intervention as each successive generation retires.<sup>65</sup> Complete reliance on one's parents is thus an unrealistic expectation for financing higher education.

It is also unrealistic to expect students to completely self-fund their educations through their savings, work, or entrepreneurship. As the cost of tuition has far outpaced the growth of minimum wage jobs, students' ability to self-finance has plummeted. To pay for one year of tuition at a public university in 2013 (to say nothing of a private institution whose cost is often double that of a public institution) requires approximately 991 hours of minimum wage work, equivalent to over six months of full time 40-hour work-weeks.<sup>66</sup> This is an impossible and unrealistic expectation of students and this cost accounts for tuition alone, without fees, books, or room and board. Equally impossible is the expectation that a student, through entrepreneurship, can fund their education. It is common knowledge that overwhelmingly, startups fail. Yet, of those

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<sup>65</sup> Emily Gersema and Jennifer Ailshire, "Some Parents Financially at Risk Taking on Child College Debt," *University of Southern California*, 2016, <https://pressroom.usc.edu/some-parents-financially-at-risk-taking-on-child-college-debt/>.

<sup>66</sup> Svati Kirsten Narula, "The Myth of Working Your Way Through College," *The Atlantic*, 2014, <https://www.theatlantic.com/education/archive/2014/04/the-myth-of-working-your-way-through-college/359735/>.

startups which are ultimately successful, the average founder's age was 40 years old.<sup>67</sup>

Decades of experience and networking, not to mention the high likelihood of having a college education, contribute to the success of startups later in life.<sup>68</sup> Self-financing, through entrepreneurship or a minimum wage job, is not the solution to paying for college.

Gifts, donations, scholarships, and grants fund a significant portion of students' higher education costs. While 34% of tuition costs were paid for by funding of this variety, in 2016 only 13% of students funded their expenses solely via scholarships, grants, and gifts.<sup>69</sup> Fully funding one's education with scholarships, grants, and gifts is an option available and fulfilled for only a small subset of students. Nevertheless, on average, each student receives approximately \$7,190 in grants, with the government funding 41% of all grant aid (2013 current dollars).<sup>70</sup> Scholarship support, from government or private foundations, cannot reasonably be expected to fully account for the rapidly rising costs of higher education, especially in an administration aiming to reduce government spending across the board. While the contribution of scholarships, grants, and gifts to the overall education-financing matrix is important, especially for

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<sup>67</sup> Roya Wolverson, "The Best Age for a Start-Up Founder," *Time Magazine*, 2013, <http://business.time.com/2013/03/14/ask-the-expert-the-best-age-for-a-start-up-founder/>.

<sup>68</sup> Vivek Wadhwa, Richard Freeman, and Ben Rissing, "Education and Tech Entrepreneurship" (Kansas City, 2008), [http://www.kauffman.org/~media/kauffman\\_org/research\\_reports\\_and\\_covers/2008/06/education\\_tech\\_ent\\_061108.pdf](http://www.kauffman.org/~media/kauffman_org/research_reports_and_covers/2008/06/education_tech_ent_061108.pdf).

<sup>69</sup> Sallie Mae and Ipsos Public Affairs, "How America Pays for College: 2016."

<sup>70</sup> The College Board, "Trends in Student Aid" (New York, 2013), <http://trends.collegeboard.org/sites/default/files/student-aid-2013-full-report.pdf>.



students of lower economic status, it is untenable for them to resolve the entirety of college costs.

Of all options, debt funding for students has contributed most reliably to students' ability to attain higher education; however, reliance solely on debt is unsustainable. To be expected, debt-financing has been extensively utilized to fill the gap between wages and rising tuition, with annual student borrowing rising from \$24 billion in 1990 to \$110 billion in 2012 (in current 2012 dollars).<sup>71</sup> However, this four-fold increase corresponds with only a 62% increase in student enrollment, a dollar figure vs. enrollment figure discrepancy demystified slightly by the trebling of per-student borrowing from \$2,485 in 1991 to \$6,928 in 2012.<sup>72</sup> Students are borrowing more now than their parents did in generations prior to fund their college education. This increased borrowing has also left them in considerable debt. Between 2003 and 2012, the percentage of students graduating debt free from public, private, and for-profit institutions decreased as students took on greater quantities of debt and those graduating with debt in excess of \$30,000 continues to increase. As of 2012, over 30% of students graduate with more than \$30,000 in student debt.<sup>73</sup> As of December 31, 2016, student debt has grown to over \$1.31 trillion.<sup>74</sup> Just a decade ago, in the first quarter of

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<sup>71</sup> Richard Fry, "The Growth in Student Debt," *PewResearchCenter*, 2014, <http://www.pewsocialtrends.org/2014/10/07/the-growth-in-student-debt/>.

<sup>72</sup> Ibid.

<sup>73</sup> College Board, "Cumulative Debt of Bachelor's Degree Recipients by Sector over Time," *College Board*, 2012, <https://trends.collegeboard.org/student-aid/figures-tables/cumulative-debt-bachelors-recipients-sector-time>.

<sup>74</sup> New York Federal Reserve, "Federal Reserve Bank of New York Household Debt and Credit: February 2017" (New York, 2016),

2007, student debt was less than half, at \$544 billion.<sup>75</sup> While student debt doubled in the past decade, full time student enrollment has increased only 10%, from slightly less than 10 million students in 2006 to 11 million students in 2016.<sup>76</sup> This translates into, on average, each graduate of the class of 2016 receiving with their diploma a bank statement indicating \$37,172 in student debt.<sup>77</sup> A scant ten years prior, the class of 2006 crossed the stage with an average student debt figure approximately 45% lower, at \$20,789.<sup>78</sup> Such a tremendous increase in student debt corresponds with greater rates of loan defaults and delinquencies. 11.2% of national student loans are over 90 days delinquent as of the fourth quarter of 2016, up nearly double from a decade ago when only 6% of loans were three months overdue.<sup>79</sup>

Among this trove of negative data is a dim but growing spot of brightness in that student loan default rates are gradually decreasing. As of 2016, 11.3% of borrowers defaulted on their student loans.<sup>80</sup> These students, whose loans originated between

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[https://www.newyorkfed.org/medialibrary/interactives/householdcredit/data/pdf/HHD\\_C\\_2016Q4.pdf](https://www.newyorkfed.org/medialibrary/interactives/householdcredit/data/pdf/HHD_C_2016Q4.pdf).

<sup>75</sup> Federal Reserve Bank of St. Louis, "Student Loans Owned and Securitized, Outstanding" (St. Louis, 2017), <https://fred.stlouisfed.org/series/SLOAS>.

<sup>76</sup> National Center for Education Statistics, "The Condition of Education - Participation in Education - Postsecondary - Undergraduate Enrollment - Indicator May (2016)," *National Center for Education Statistics*, 2016, [https://nces.ed.gov/programs/coe/indicator\\_cha.asp](https://nces.ed.gov/programs/coe/indicator_cha.asp).

<sup>77</sup> Josh Mitchell, "Student Debt Is About to Set Another Record, But the Picture Isn't All Bad," *Wall Street Journal*, 2016, <http://blogs.wsj.com/economics/2016/05/02/student-debt-is-about-to-set-another-record-but-the-picture-isnt-all-bad/>.

<sup>78</sup> Ibid.

<sup>79</sup> New York Federal Reserve, "Federal Reserve Bank of New York Household Debt and Credit: February 2017."

<sup>80</sup> US Department of Education Federal Student Aid, "FY 2013 Official 3-Year National Cohort Default Rate" (Washington DC, 2016), <https://ifap.ed.gov/eannouncements/attachments/2016OfficialFY2013CDRBriefing.pdf>.

fiscal year 2012 and 2013, are part of a continuous three-year trend of falling default rates which began in 2013 when student loan default rates peaked at 14.7%.<sup>81</sup>

### ***The Success of Income Contingent Repayment***

The US Department of Education attributes a number of factors to these ever-decreasing default rates, highlighting the Obama Administration as having “taken unprecedented measures to provide borrowers more options to avoid default, manage their student debt and stay on track to repayment.”<sup>82</sup> These measures in particular include increasing rates of enrollment in several income-driven repayment options such as PAYE (Pay As You Earn), REPAYE (Revised Pay As You Earn), IBR (Income-Based Repayment), and ICR (Income-Contingent Repayment).<sup>83</sup> Common among each of these payment plans is a cap on the percentage of a debtor’s income devoted to repaying student loans. These caps are 10% of income above 150% of the poverty line for PAYE, REPAYE, and IBR while for ICR, repayments are “lesser of either 20% of your discretionary income or what you would pay with a fixed plan over twelve years.”<sup>84</sup> The payments for income-driven repayment plans are recalculated annually with respect to a student’s fluctuating income. The income percentage rate is thus variable up to the upper threshold of 10%; it is not fixed at the outset of the agreement.

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<sup>81</sup> Ibid.

<sup>82</sup> Press Office, “National Student Loan Cohort Default Rate Declines Steadily” (Washington DC, 2016), <https://www.ed.gov/news/press-releases/national-student-loan-cohort-default-rate-declines-steadily>.

<sup>83</sup> Ibid.

<sup>84</sup> Kat Tretina, “Is an Income-Driven Repayment Plan the Best Choice for You?,” *Student Loan Hero*, 2016, <https://studentloanhero.com/featured/income-driven-repayment-plan-think-twice/>.

The novelty of these programs, having been introduced by President Obama only starting in 2012, means that not enough time has passed to indicate the viability and success of income-driven repayment plans. Nevertheless, Findeisen and Sachs have modeled that government-provided debt financing “coupled with income-contingent repayment can always be designed in a Pareto optimal way.”<sup>85</sup> Income-contingent repayment plans can work to address the academic needs of students. Legally, Brooks concurs and has made a case for income-contingent repayment options for education financing, stating “by providing tuition for all, but demanding repayment only as a function of income, the government can meet the demands both of an economy that requires more skills and of justice and fairness in ensuring that family wealth is not a barrier to entry.”<sup>86</sup>

Circumstantially, the decline in default rates following the introduction of income-driven repayment plans bodes well for their potential success as an education-financing tool. However, their success must also be couched within the context of a

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<sup>85</sup> Sebastian Findeisen and Dominik Sachs, “Education and Optimal Dynamic Taxation: The Role of Income-Contingent Student Loans,” *Journal of Public Economics* 138 (2016): 1–21, doi:10.1016/j.jpubeco.2016.03.009.

<sup>86</sup> John R. Brooks, “Income-Driven Repayment and the Public Financing of Higher Education,” *Georgetown Law Journal* 104 (2016): 229–89, <http://scholarship.law.georgetown.edu/cgi/viewcontent.cgi?article=2397&context=facpub>.

growing job market,<sup>87</sup> a bullish stock market since June 2009,<sup>88</sup> and modest but increasing levels of disposable personal income.<sup>89</sup>

Nevertheless, several realities persist which drive the need for greater variety in the options available to finance higher education. These include levels of disposable income that, while gently rising, are still significantly lagging inflation and have even more so stagnated with respect to skyrocketing tuition costs. Furthermore, not attaining a college degree is increasingly not an option with an ever-widening wage discrepancy between those with and without a college degree. For those especially in the bottom income quartile, higher education is the only tool permitting economic mobility. As college increasingly becomes a luxury attainable only to the wealthy, the need for innovative financing options will continue increasing. Debt, the most realistic and common tool utilized to finance higher education inherently presents significant systemic risk should students be unable to repay their loans back sufficiently. While debt once was the solution to the shortcomings of scholarships, grants, gifts, savings, and family and student income, the rate at which college costs are swelling makes even modest wage gains wholly insufficient. Of the financing options available to students, one of the most promising has been the income-driven repayment models pushed by

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<sup>87</sup> Phil Gardner and Andy Henion, "College Job Market to Continue Torrid Pace," *Michigan State University*, 2016, <http://msutoday.msu.edu/news/2016/college-job-market-to-continue-torrid-pace/>.

<sup>88</sup> National Bureau of Economic Research, "US Business Cycle Expansions and Contractions," *National Bureau of Economic Research*, 2017, <http://www.nber.org/cycles.html>.

<sup>89</sup> Bureau of Economic Analysis, "Personal Income and Outlays, February 2017" (Washington DC, 2017), <https://www.bea.gov/newsreleases/national/pi/pinewsrelease.htm>.

President Obama during the latter years of his tenure. The paradoxical necessity for higher education in the midst of increasing college prices and lagging wages means that all options must be explored. An under-utilized but potentially promising solution could come, in part, through income share agreements.

## **Income Share Agreements**

At their simplest, income share agreements, or ISAs, are contracts between investors and students wherein an investor funds, wholly or partially, a student's college expense in return for a percentage of that student's income over a pre-determined time frame. The idea of a student accessing their future earnings to finance their present education needs is not new. A very simple model for a \$20,000 investment in a student at a 5% income share rate for ten years is presented in *Table 1*.<sup>90</sup> *Table 2*<sup>91</sup> outlines a traditional student loan, for an equal repayment time frame of 10 years and a principal of \$20,000. These provide a basic outline of income share agreements and demonstrate that at current rates and with respect specifically to monthly payments, income share agreements are comparable to debt financing for higher education.

### ***Informal Income Share Agreements***

The idea of investing in an entity today to guarantee access to a portion of that entity's future success is not new. Such an arrangement in corporate finance is akin to the purchase of bonds by investors or the distributions of bonds by a firm. In much the

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<sup>90</sup> See *Appendix, Table 1*.

<sup>91</sup> See *Appendix, Table 2*.

same way, contracts resembling income share agreements have existed for centuries, albeit much more informally.<sup>92</sup> Communities have long invested in their most talented members such that the investment recipient can be empowered to realize some potential business or education. Upon reaching their financial success, the investment recipient allocates a portion of their income back to their supporting community, typically in the form of remittances.

Informal income share agreements are a cultural reality for much of the world. Particularly among the collectivist societies of Asia, Latin America, and the Middle East, there exists among parents an expectation that, after decades of raising their children, those children will in return support their parents in retirement. Pursuant to this cultural reality and in return for a lifetime of financial support, particularly in funding his education, the author of this thesis and his two brothers have each pledged 20% of their annual income to their parents.

### ***Formal Income Share Agreements***

Formal income share agreements are a much more recent phenomenon. The first to describe an income share agreement was American economist and Nobel prize winner, Milton Friedman in his 1955, *The Role of Government in a Free Society*.<sup>93</sup> Here,

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<sup>92</sup> American Institutes for Research, “The Potential Market for Income Share Agreements Among Low-Income Undergraduates: An Issue Brief for Policymakers and Advocates” (Washington, DC, 2015), <http://www.air.org/sites/default/files/downloads/report/Income-Share-Agreements-ISAs-Potential-Among-Low-Income-Undergraduates-Sept-2015.pdf>.

<sup>93</sup> Miguel Palacios, Tonio Desorrento, and Andrew P Kelly, “Investing in Value Sharing Risk: Financing Higher Education Through Income Share Agreements,” 2014,

Friedman dedicates a chapter to the duties of the federal government in ensuring access to education for its citizens. Among his solutions include a call for

“the central government, [to] make funds available to [students] to finance [their] education, not as a subsidy but as "equity" capital. In return, he would obligate himself to pay the state a specified fraction of his earnings above some minimum, the fraction and minimum being determined to make the program self-financing.”<sup>94</sup>

Much like President Obama’s income-driven repayment programs, Friedman called for the federal government to fund student’s education in a manner proportionate to the student’s ability to pay back the government’s investment, i.e., income share agreements.

Friedman outlines a distinction between general education and vocation education, with differing solutions for each. For a student’s general education, one whose intention is to instill among society “some common set of values and ... a minimum degree of literacy and knowledge on the part of most citizens,” Friedman advocated for a voucher system wherein the government directly subsidizes individuals’ payments to private educational institutions for a basic education.<sup>95</sup> As a result of a standardized set of basic information, multiple “neighborhood benefits” propagate.<sup>96</sup>

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[http://www.aei.org/wp-content/uploads/2014/02/-investing-in-value-sharing-in-risk-financing-higher-education-through-income-share-agreements\\_083548906610.pdf](http://www.aei.org/wp-content/uploads/2014/02/-investing-in-value-sharing-in-risk-financing-higher-education-through-income-share-agreements_083548906610.pdf).

<sup>94</sup> Milton Friedman, “The Role of Government in Education,” in *The Role of Government in a Free Society* (New Brunswick: Rutgers University Press, 1955),

<http://la.utexas.edu/users/hcleaver/330T/350kPEEFriedmanRoleOfGovttable.pdf>.

<sup>95</sup> Ibid.

<sup>96</sup> Ibid.



These neighborhood benefits are an infinite series of positive externalities whose value can never be calculated and are thus a valid government investment.

With respect to higher education, labeled by Friedman as vocational education, more pragmatic and acute benefits are reaped by society, government, and the individual. Vocational education endows an individual with specific skills thereby raising their individual economic value. In order for both investor and recipient to benefit from the lifetime economic value of an education, Friedman asserts that investors should be able to “‘buy’ a share in an individual's earning prospects: to advance him the funds needed to finance his training on condition that he agree to pay the lender a specified fraction of his future earnings.”<sup>97</sup> Friedman also hints at a basket of student investments, similar to an exchange traded fund or a mutual fund such that “a lender would get back more than his initial investment from relatively successful individuals, which would compensate for the failure to recoup his original investment from the unsuccessful.”<sup>98</sup>

Under Friedman’s model, individuals, the government, and society all benefit. Individuals benefit from the ability to receive a higher rate of return on their efforts, thanks to an elevated education, than they otherwise would have been able to receive. Governments benefit from instituting this program because collection of payment would be automatically deducted from wages the way other taxes are currently collected. This, in the stead of loan collectors seeking debtors, would save government

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<sup>97</sup> Ibid.

<sup>98</sup> Ibid.

significantly, according to Friedman. Society as a whole benefits from the socialistic nature of income share agreements in equalizing attainment of education across the income spectrum. Friedman levies a special critique on the status quo for ensuring that poor, “‘non-competing’ groups” are unable to compete with their wealthy counterparts because of an “unavailability of the necessary capital to many individuals, among whom must be large numbers with equal ability” which results in perpetual “inequalities in wealth and status.”<sup>99</sup>

### ***Income Share Agreement Examples***

President Barack Obama’s income-driven repayment plans are the closest the United States federal government has come to adopting Friedman’s government-backed income share agreements. Meanwhile, the development of private market income share agreements has been rather gradual, at best. Dr. Miguel Palacios, co-founder of *Lumni*, one of the few private facilitators for income share agreements in the United States, asserts that private financing of income share agreements is stymied in part because “our biggest competitor is the United States government who can take a loss on the ISAs whereas we cannot.”<sup>100</sup> Despite this competitor, several analogues have been developed over the past half century whose fundamental underpinning approximates Friedman’s assertion that individuals should have the option to presently access their future earnings.

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<sup>99</sup> Ibid.

<sup>100</sup> Kamil Fadel, “Interview with Dr. Miguel Palacios, Co-Founder of Lumni” (Nashville, 2016).

At the most radical is Mike Merrill, known as “Portland’s ‘IPO’ Man” and “the world’s only publicly traded person.”<sup>101</sup> In short, Merrill has issued shares of himself to be publicly traded on his own stock exchange since January 21<sup>st</sup>, 2008 at an IPO of \$1.00. As of today, his shares are trading at approximately \$4.61, with trading volume peaking at over 1,000 shares traded in March of 2013.<sup>102</sup> Merrill’s unique experiment allows those who purchase shares in him to influence the decisions he makes, from registering as a Republican to deciding on a vasectomy, with those possessing the greatest number of shares endowed with the greatest influence over Merrill’s decisions.<sup>103</sup> Those owning equity in Merrill are not, however, offered direct or guaranteed financial compensation nor are they offered outright control over his life. Rather, his shareholders are allocated a dividend of all ancillary profits Merrill reaps outside of his main source of income. Additionally, upon Merrill’s death, his shareholders will each receive a portion of his life insurance payout. Merrill has remained remarkably resolute in his commitment to his self-IPO. This includes making decisions according to his largest shareholders and when those decisions conflicted with the desires of his girlfriend, he’d simply suggest she “buy more shares” to exercise

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<sup>101</sup> Mike Merrill, “K. Mike Merrill,” *Mike-Merrill.com*, 2017, <http://www.mike-merrill.com/>.

<sup>102</sup> Ibid.

<sup>103</sup> Shu-Yi Oei and Diane Ring, “Human Equity? Regulating the New Income Share Agreements,” *Vanderbilt Law Review* 68, no. 3 (2015): 681–721, <http://go.galegroup.com.ezproxy.rollins.edu:2048/ps/i.do?&id=GALE%7CA419762788&v=2.1&u=wint47629&it=r&p=AONE&sw=w&authCount=1#>.

greater control over him.<sup>104</sup> The relationship soon ended.<sup>105</sup> Overall, the sorts of income share agreements outlined in this essay differ significantly from Merrill's individual equity sale. In principle, however, Merrill illustrates the possibility of individuals securitizing their productivity. "Portland's IPO Man" also makes clear the potential harms inherent to human equity investment and the need for a regulatory framework to protect both investor and individual.

A step above Merrill's individual IPO is musician David Bowie's issue of "Bowie Bonds." In 1997, by soliciting the assistance of an investment bank, The Pullman Group, Bowie raised \$55 million through a bankruptcy-remote "special purpose vehicle" on the expectation of future earnings acquired from concerts, royalties, and song sales.<sup>106</sup> To raise money in the present, Bowie sold to investors the right to a portion of his future income with the contract promising a repayment of principal plus 7.9% annual interest from concert, royalty, and song sales.<sup>107</sup> This altogether is quite similar to corporate bond issuance. Just as investors, confident in the future performance of a firm, purchase their bonds at a specified and risk adjusted rate, so did Bowie's private investors. Bowie Bonds differ primarily from corporate bonds simply in that "markets were willing to invest in an *individual's* capacity to generate future cash flows out of intangible assets"

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<sup>104</sup> Joshua Davis, "Meet the Man Who Sold His Fate to Investors at \$1 a Share," *Wired*, 2013, <https://www.wired.com/2013/03/ipo-man/>.

<sup>105</sup> *Ibid.*

<sup>106</sup> Oei and Ring, "Human Equity? Regulating the New Income Share Agreements."

<sup>107</sup> *Ibid.*

as opposed to a corporation.<sup>108</sup> David Bowie, with a long and successful music career, engendered confidence among investors in his ability to continue positive cash flow. This further illustrates the possibility that income share agreements are not an impossible option for those seeking to fund some venture. Of course, significant differences are evident, including the difficulty associated with assessing income and cash flow potential between a college student and an accomplished international musician. This aside, the autonomous nature of Bowie Bonds, namely, the inability for investors to dictate or influence the exact content of Bowie's songs and his ability to maintain agency over exactly how it was he would procure financial gain from his music sales, are a Bowie Bond feature which, unlike Merrill's IPO, are inherent to income share agreements.

History has bequeathed a final income share agreement which very closely approximated the principles outlined by Friedman: Yale's Tuition Postponement Program. Between 1971 and 1976, Yale offered a voluntary program in response to government reductions in grants and loans offered to the university.<sup>109</sup> Students entering the tuition postponement program agreed to its two primary features. The first was a repayment structure where loan repayment was calculated as 0.4% of annual

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<sup>108</sup> Miguel Palacios Lleras, "The Evolution of Human Capital Contracts," in *Investing in Human Capital: A Capital Markets Approach to Student Funding* (New York: Cambridge University Press, 2004), 50–51.

<sup>109</sup> Miguel Palacios Lleras, "The Implementation of Income-Contingent Loans," in *Investing in Human Capital: A Capital Markets Approach to Student Funding* (New York: Cambridge University Press, 2004), 123–31.

income for every \$1,000 borrowed.<sup>110</sup> The second feature of this repayment scheme was a distribution of debt among cohorts. Each student joining Yale's Tuition Postponement Program was grouped into cohorts wherein income-based repayments did not necessarily write down an individual's debt, but rather, were applied to the collective debt of the cohort, regardless of whether certain cohort members defaulted on their loans.<sup>111</sup> Assignment to a cohort was done randomly which meant that no matter what, high income earners paid a greater share into the cohort's debt than lower income earners, proving to be a particularly contentious issue among the Ivy's graduates.<sup>112</sup>

Satisfying the income share obligation could be done in three ways. First was a buyout of one's obligation wherein egress from the cohort's obligations was offered in return for repaying 150% of the original individual obligation.<sup>113</sup> The cohort's obligation was extinguished once 150% of the collective debt was repaid to the university.<sup>114</sup> Should the preceding two options not be selected, the overall repayment scheme was capped at a thirty five year term after which whatever left over capital due to investors was written off.<sup>115</sup> Arranging students into "cohorts," intended to diversify the university's default risk on the loans, proved to be a serious hindrance to the program's

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<sup>110</sup> Gregorio Caetano et al., "Measuring Aversion to Debt: An Experiment Among Student Loan Candidates" (Washington, DC, 2011), [http://www2.owen.vanderbilt.edu/miguel.palacios/index\\_files/CPPMeasuringAvesionto debt.pdf](http://www2.owen.vanderbilt.edu/miguel.palacios/index_files/CPPMeasuringAvesionto debt.pdf).

<sup>111</sup> Palacios Lleras, "The Implementation of Income-Contingent Loans."

<sup>112</sup> Oei and Ring, "Human Equity? Regulating the New Income Share Agreements."

<sup>113</sup> Palacios Lleras, "The Implementation of Income-Contingent Loans."

<sup>114</sup> Ibid.

<sup>115</sup> Oei and Ring, "Human Equity? Regulating the New Income Share Agreements."

success. As cohort participants defaulted, their balance was redistributed among remaining cohort members, leading many students to feel their debts were unwarrantedly excessive. Furthermore, significant discontent was reported as a result of the program's duration.<sup>116</sup> Assuming a student graduates at age 22, payments last effectively until age 57, a span which encompasses nearly all of an individual's productive years. While other long term loan durations are socially acceptable, such as the thirty-year mortgage, the intangible nature of an education (unlike a home which can be sold to extinguish a debt) makes it psychologically more difficult to accept.<sup>117</sup> Despite these hindrances, Yale's Tuition Postponement Program at least demonstrates the possibility of income share agreements. While particular problems exist, namely that of duration and redistributive debt (through the cohort system), there is no reason to conclude such features are *de rigueur* in a contemporary application of income share agreements.

This thesis intends to examine the degree to which income share agreements are compatible with Islamic principles and not whether the examples of Merrill, Bowie, or Yale comply with *shari'ah*. While each of the above examples of historic applications approximate those outlined by Friedman, they each strayed from the core concept of income share agreements. Additionally, Friedman's conception of purchasing equity stakes in students' future earnings does not entirely encapsulate the income share agreements this essay intends to examine. Most gravely, Friedman articulates support

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<sup>116</sup> Palacios Lleras, "The Implementation of Income-Contingent Loans."

<sup>117</sup> *Ibid.*

for government, municipal or federal, purchase of equity stakes as opposed to privately-backed student financing. Additionally, *shari'ah* compliance begins at the individual level, thus, Friedman's top down approach to equity-based educational financing is not necessarily appropriate for an inquiry examining individual investor participation in an income share agreement.

### ***The Nature of Income Share Agreements***

To analyze the *shari'ah* compliance of income share agreements, it is necessary to outline exactly what constitutes an income share agreement at its core. These instruments are relatively simple, with only three core stipulations:<sup>118</sup>

1. The percentage of annual income to be allocated to an investor.
2. The duration of the income share agreement.
3. The terms of investor student contract.

It is up to the student and investor to determine what percentage of income the student will allocate to their investor. There are two boundaries between which the ideal rate can be determined. The first is the lower boundary, i.e., at what point does an investment's return not possess sufficient net present value for an investor to place their money in that vehicle. The standard risk-free investment is a US Treasury Bond. Whatever rate an investor selects must be above the rate of return for a US Treasury Bond of equal duration. Of course, investing in a student's future income is significantly

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<sup>118</sup> Miguel Palacios Lleras, "How Human Capital Contracts Work," in *Investing in Human Capital: A Capital Markets Approach to Student Funding* (New York: Cambridge University Press, 2004), 53–63.



more risky than investing in US Treasury Bonds, so the expected rate of return must be adjusted for the risk of the underlying asset. Calculating that risk can be extremely difficult but there are several starting points. These include the historic salaries of graduates from various majors at various institutions. A student studying finance at an Ivy League institution is much more likely to command a lower risk premium, thus a lower income share rate, than perhaps a student studying horticulture at a lower ranked institution.

Additionally, numerous external and macroeconomic factors must be considered. If the United States economy is entering a recession or automation has spread into a specific career sector, then the risk premium for a particular student goes up and the income share rate must increase accordingly. Beyond the difficulty of assigning risk premiums to different majors at different institutions, there exists both mathematic and ethical difficulties associated with assigning a risk premium according to intrinsic characteristics of a student. Palacios outlines a contradiction between the philosophies of two contemporary firms offering income share agreements.

MyRichUncle, a subsidiary of MRU Holdings Inc., believed that they were able to better predict the earning potential of students using computer algorithms which accounted for the academic and credit history of students.<sup>119</sup> Human Capital Resources Inc., conversely, believes that income share agreements can never be priced perfectly because the student will always better understand their intrinsic potential than an investor. Investors can attempt to bridge this asymmetry by mandating their students

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<sup>119</sup> Ibid.

submit to personality tests because, according to Heineck,<sup>120</sup> Heckman et al.,<sup>121</sup> Klontz,<sup>122</sup> and Borghans,<sup>123</sup> different personality traits vary in their predictive power for future financial success. However, affording favorable rates to specific personalities intuitively seems dubious at best and at worst can suffer from the inherent biases that standardized testing almost universally suffers from.

Whatever rate is selected must also be considerate of an upper boundary. The greater share of income a student is compelled to contribute to their investor, the less likely they are to make contributions and the more likely they are to default.<sup>124</sup> There must be a hard upper boundary legislated by Congress for income share agreements to prevent abuse because no matter the contracted autonomy between an investor and student, an investor commanding disproportionate dominion over a student's income tacitly controls that student. So long as the payment scheme offered by an income share agreement is comparable to that of alternative financing tools, i.e. the income share

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<sup>120</sup> Guido Heineck, "Does It Pay To Be Nice? Personality and Earnings in the UK," *Industrial and Labor Relations Review* 64, no. 5 (2011): 1020–38, [http://www2.econ.iastate.edu/classes/econ321/orazem/Heineck\\_BeNice\\_ILRR2011.pdf](http://www2.econ.iastate.edu/classes/econ321/orazem/Heineck_BeNice_ILRR2011.pdf).

<sup>121</sup> James J Heckman, Jora Stixrud, and Sergio Urzua, "The Effects of Cognitive and Noncognitive Abilities on Labor Market Outcomes and Social Behavior," *Journal of Labor Economics* 24, no. 3 (2006), [http://jenni.uchicago.edu/papers/Heckman-Stixrud-Urzua\\_JOLE\\_v24n3\\_2006.pdf](http://jenni.uchicago.edu/papers/Heckman-Stixrud-Urzua_JOLE_v24n3_2006.pdf).

<sup>122</sup> Bradley Klontz et al., "The Psychology of Wealth: Psychological Factors Associated with High Income," *Journal of Financial Planning* 27, no. 12 (2014): 46–53, <https://www.onefpa.org/journal/Pages/DEC14-The-Psychology-of-Wealth-Psychological-Factors-Associated-with-High-Income.aspx>.

<sup>123</sup> Lex Borghans et al., "The Economics and Psychology of Personality Traits," *The Journal of Human Resources* 43, no. 4 (2009): 972–1059, [http://jenni.uchicago.edu/papers/Borghans\\_Duckworth\\_etal\\_2008\\_JHR\\_v43\\_n4.pdf](http://jenni.uchicago.edu/papers/Borghans_Duckworth_etal_2008_JHR_v43_n4.pdf).

<sup>124</sup> Palacios Lleras, "How Human Capital Contracts Work."

rate is comparable to that of a conventional loan as demonstrated in *Table 1* and *Table 2* of the *Appendix*, then the rate is generally not abusive.<sup>125</sup>

The duration of an income share agreement is also an extremely important component. As made clear by the Yale Tuition Postponement Program, a term of 35 years is so considerable as to effectively remove income share agreements from students' consideration. President Obama's income-driven repayment programs max out at 25 years and his most popular programs mature after ten years. Just like the income share rate, the income share agreement duration has an upper and lower boundary. A satisfactory lower boundary is necessary to ensure investors are attracted enough to the contract to contribute to the student's education financing needs. On the upper end, a 35-year term has proven to be simply excessive and may even border as abusive. Of course, the potential for abuse under an income share agreement at least is less than that of a conventional student loan because, should the student not possess sufficient income for a year, they are not required to make that year's payment whereas a loan is essentially ceaseless in demand.

The structure of the income share agreement's duration, along with many other features of the contract, can be clarified through the terms of the investor-student contract. To ensure income share agreements are attractive to students and ethical overall, the terms of a contract must be adjusted so that the income share rate is paid only once a graduate's income is sufficient as to not force them into poverty. Both Friedman and President Obama's income contingent repayment plans mandate this

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<sup>125</sup> Ibid.

minimum income threshold. On the other end of the spectrum, should a graduate earn a position of sufficient wealth as to render their income share agreement unfavorable, the contract should specify the parameters of a buyout wherein graduates pay an agreed upon figure to close the contract. Beyond this, it is important for an investor and student to agree on terms deciding payment during “off years,” those years when a student’s income due to financial hardship, pursuit of graduate education, or any other reason renders the student unable to remunerate their investor. Some investors may simply let these payments lapse, with the contract closing after an agreed upon duration no matter the income share rate paid or not paid during the contract’s effective course. This may lead to a higher risk income share rate. Other investors can include clauses for grace years wherein for every year a contract is not paid at all, the contract is extended one additional year.

### ***Income Share Agreement vs. Loan***

Beyond these three core stipulations are several conceptual differences between income share agreements and traditional student loans. Income share agreements are investments, not loans. The contract’s value is derived from the income potential of a student. The investor thus assumes the risk that the student’s income potential is not fully realized and in such circumstances, there is no recourse for the investor, it is simply a failed investment indistinguishable from an erroneous stock, bond, or option trade.<sup>126</sup> Eventually, it is entirely possible for income share agreements to be securitized and

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<sup>126</sup> This risk is a component of risk adjustment measures that must be calculated when determining an appropriate income percentage rate.

bundled into tradeable tranches with call and put options, called human capital options, proposed by Dr. Palacios as a means of hedging against potential losses from income share agreements.<sup>127</sup> Human capital options are sufficiently complex as to warrant their own thesis.

Income share agreements also differ from loans in the repayment amount due to the original investor. Monthly loan payments are composed of an allocation to principal and interest with an invariable monthly bill, assuming a fixed loan rate. A student can expect, for example, to pay a monthly bill of \$232.49 every month for ten years.<sup>128</sup> While this provides consistency in expected payment rates, it does not account for a student's ability, or crucially, their inability to repay the debt. No matter the financial situation of a student, the monthly student loan bill will persist until the debt is satisfied or restructured and if it does change, it is likely to increase as a result of higher interest due to default or late payment. This presents significant downside risk for the student in the event that their career and financial aspirations are not realized after graduation. Student loans typically allow for a post-graduation grace period wherein for several months the student is not required to begin loan repayment. Should work with sufficient income not be attained by the time debt repayment is due, the student enters delinquency and default which significantly harms their credit. This, combined with the very brief credit history of students, hinders their ability to borrow in the future. This

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<sup>127</sup> Miguel Palacios Lleras, "Human Capital Options," in *Investing in Human Capital: A Capital Markets Approach to Student Funding* (New York: Cambridge University Press, 2004), 81–99.

<sup>128</sup> Exemplified in *Table 2* of the *Appendix*.

long-term inability to attain credit affects their employment potential as employers increasingly use credit checks in hiring decisions.<sup>129</sup> Additionally, their ability to secure housing, to make long term investments, and to build a foundation for retirement are also negatively affected. Student loans may be conventional, but they are not risk free.

Income share agreements eschew the harms of traditional student loans considerably. Unlike loans, a student's monthly repayment bill fluctuates in proportion to their income. Lower income students pay a lower repayment than originally borrowed or than they would likely pay to a bank. Theoretically, a student could graduate from school and choose to live as a stereotypical "beach bum." Despite a life of extreme leisure and little work, the student suffers no repercussions from their investor and must simply be content with not attaining a high income. Even in this very unlikely scenario, a student graduates with a degree, little debt, and with intact credit. Higher income students, meanwhile, may ultimately pay more to an investor than perhaps they'd pay to a bank, but that excess can be understood as a cost insuring against potential financial ruin resulting from a period when a student would normally be in default. Income share agreements avoid significant downside risk for students especially considering that the worst-case scenario entails a student generating excessive income and paying an investor more than they would have paid via a bank loan. This can hardly be seen as an existential problem and the terms of an income share agreement can include a buyout option negating this possibility.

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<sup>129</sup> Justina Victor et al., "Background Checking—The Use of Credit Background Checks in Hiring Decisions" (Alexandria, 2012), <https://www.shrm.org/hr-today/trends-and-forecasting/research-and-surveys/Pages/creditbackgroundchecks.aspx>.

Income share agreements have been a part of human culture for a long while but have only recently become formalized by modern financial institutions. They consist simply of a contract between a student and investor that stipulates three things: (1) income share rate, (2) contract duration, and (3) terms and conditions of the contract. Such a method of educational financing provides many benefits to students but most crucially is their consistency in affordability. Protecting against downside risk, income share agreements ensure that when a student cannot pay for their loan, they are not compelled to do so and they are not unduly punished for failing to live up to their lender's demands. Income share agreements provide the flexibility necessary in a rapidly changing economy that the rigidity of traditional loans cannot as easily accommodate. There have been numerous examples of income share agreements in the past with the most successful being that of President Obama and backed by the United States federal government. Such success should be transferred to private markets. Among the available markets in the United States who may be attracted to income share agreement investment are those hoping to fulfill certain religious values in concert with their investments. Muslim-Americans specifically are a potential market for income share agreement investments, though this hinges on the degree to which they are *shari'ah* compliant. To evaluate their compliance, it is first necessary to examine the components of *shari'ah* values.

## ***Shari'ah* Values**

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*Shari'ah* is a heavy word. In the west and among political conservatives, *shari'ah* bears the responsibility for all that is wrong in the Middle East. It summarizes female subjugation, socialism, and every anti-American tenet imaginable. But they do not know *shari'ah*. Among political liberals, meek apologies are made on behalf of Islam, either excusing *shari'ah's* apparent evil or wholly evading its discussion in the first place. They also do not know *shari'ah*. This lack of understanding breeds significant fear, a fear so tangible that seven US states have banned *shari'ah* law and all but 16 states have considered imposing these bans in the first place.<sup>130</sup> These legislative efforts, often struck down due to their inherently discriminatory intention,<sup>131</sup> arise despite no organized movement by any American Muslim group to impose *shari'ah* legislation. In the United States, *shari'ah* is a mystery. In the Middle East and especially since the Arab Spring, *shari'ah* occupies much of the political discourse. But, just as lay Americans are unaware of the intricacies of American jurisprudence, so too are Arabs more concerned with their everyday lives and not whether they are in adherence to abstract *shari'ah*.<sup>132</sup> Within Middle Eastern and North African communities, *shari'ah* often shapes civil and criminal legislation. In both the West and Middle East, while *shari'ah* is a mystery for

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<sup>130</sup> Liz Farmer, "Alabama Joins Wave of States Banning Foreign Laws," *Governing.com*, 2014, <http://www.governing.com/topics/elections/gov-alabama-foreign-law-courts-amendment.html>.

<sup>131</sup> *Ibid*.

<sup>132</sup> Toni Johnson and Mohammed Aly Sergie, "Islam: Governing Under Sharia," *Council on Foreign Relations*, 2014, <http://www.cfr.org/religion/islam-governing-under-sharia/p8034>.



most citizens it is understood with tremendous apparent clarity by politicians, a pseudo-clarity more often used to justify and maintain patriarchal, paternalistic, and punitive legislation than out of respect for the religious values it espouses.

*Shari'ah* is a heavy word because it holds the weight of so many unknowns. Unknowns about its definition, practitioners, arbiters, where it fits in a state's jurisprudence and political discourse, and ultimately, how (if at all) it is to be applied in a contemporary society historically influenced by the West and Western secularism. The intangible nature of *shari'ah*, and its concomitant controversy and susceptibility to manipulation, is most clearly expressed by Mustafa Maraghi<sup>133</sup> in his famous quote, "bring me anything that benefits the people, and I'll show you a basis for it in the Shariah."<sup>134</sup>

Naturally, what "benefits the people" is forever up to interpretation. Thus, preceding any discussion of Islamic finance and prior to any analysis of something as niche as Income Share Agreements, the mysteries of *shari'ah*, its depth and breadth, must be properly defined and contextualized.

Some axiomatic qualities of *Shari'ah* must be established prior to any in-depth analysis of the religion. *Shari'ah* is not a political nor is it a legal system, rather, it is a value system from which legislation can be derived. Just like law in Europe and the

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<sup>133</sup> Mustafa Maraghi was a Rector for the Al-Azhar Mosque and student of the seminal Egyptian Islamic jurist Muhammad Abduh. Abduh's importance stems from his irreplaceable contributions to the establishment of the Islamic Modernism movement. Sourced from: Jonathan Brown, *Misquoting Muhammad* (London: Oneworld Publications, 2014), 135.

<sup>134</sup> Ibid.

United States, *shari'ah* law is highly varied, ever-evolving, and a product of its environment and interpretation of its underlying principles. *Shari'ah*, despite its origins in a religion shared by 1.6 billion Muslims globally,<sup>135</sup> is not a monolithic philosophy and exists with just as much diversity as there exists between different philosophies in the United States and Europe. The heterogeneous nature of *shari'ah* can be seen even in something as fundamental to Islam as *Zakat*. One would assume that *Zakat*, considered one of the five pillars of Islam,<sup>136</sup> would be made mandatory via legislation in all states for all Muslims with either Muslim majority populations or parliaments. However, “in Jordan, Bahrain, Kuwait, Lebanon, Malaysia, and Bangladesh the collection of *zakat* is only organized by the state and regulated by law, but the alms giving is voluntary” and among the 47 Muslim majority countries, only is *zakat* an “obligatory tax in Pakistan, Sudan, Libya, and Saudi Arabia.”<sup>137</sup>

Analysis of the Qur'an as beyond a literal text is held highest by scholars such as Mahmoud Muhammad Taha who writes that “the Qur'an can never be finally and

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<sup>135</sup> Michael Lipka, “Muslims and Islam: Key Findings in the U.S. and around the World,” *Pew Research Center*, 2016, <http://www.pewresearch.org/fact-tank/2016/07/22/muslims-and-islam-key-findings-in-the-u-s-and-around-the-world/>.

<sup>136</sup> *Zakat* is one of the five pillars of Islam. The other four include the following: (1) *shahadah*: sincerely reciting the belief in Islamic monotheism and prophethood by saying, “there is no God but God and Muhammad is his prophet”, (2) *salat*: performing the five prayers daily, (3) *sawm*: fasting during the holy month of Ramadan, and (4) *Hajj*: performing once in one's life, assuming one possesses the financial means to do so, a pilgrimage to Mecca, Saudi Arabia. BBC, “BBC - Religions - Islam: Five Pillars of Islam,” BBC, 2009, <http://www.bbc.co.uk/religion/religions/islam/practices/fivepillars.shtml>.

<sup>137</sup> Franz Kogelmann, “Sidi Fredj: A Case Study of a Religious Endowment in Morocco under the French Protectorate,” in *Social Welfare in Muslim Societies in Africa*, ed. Holger Weiss (Stockholm: Elanders Gotab, 2002), 67.

conclusively explained. Islam, too, can never be concluded. Progress in it is eternal.”<sup>138</sup> If one considers that the Qur’an cannot conclusively be explained, then the values stemming from it cannot be conclusively narrowed, and thus the only path left for *shari’ah* can be continued exploration.

### ***Shari’ah’s Linguistic Foundation***

*Shari’ah*, at its most common definition, is “Islamic Law,” but this is incorrect. Further linguistic analysis reveals it to have been variably translated as “path,”<sup>139</sup> “the clear, well-trodden path to water,”<sup>140</sup> and “a path apparently to seek felicity and salvation.”<sup>141</sup> To describe it as a legal code implies much more rigidity than is inherent to its much more fluid and accommodating nature. Thus, this thesis treats *shari’ah* not as a law, but as a value system. The variability of *shari’ah*’s definition is important because it marks the beginning of an important discourse on the subtle nuances of the Arabic language, a discourse deserving its own thesis but one that will be narrowed through this digression.

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<sup>138</sup> Mahmoud Mohamad Taha, “The Second Message of Islam,” in *Liberal Islam*, ed. Charles Kurzman (New York City: Oxford University Press, 1998), 277.

<sup>139</sup> Johnson and Aly Sergie, “Islam: Governing Under Sharia.”

<sup>140</sup> BBC, “Sharia,” *BBC Religions*, 2009, [http://www.bbc.co.uk/religion/religions/islam/beliefs/sharia\\_1.shtml#top](http://www.bbc.co.uk/religion/religions/islam/beliefs/sharia_1.shtml#top).

<sup>141</sup> Mohammad Kamali, *Shari’ah Law: An Introduction* (Oxford: Oneworld Publications, 2008), 2.

Arabic, like all languages of Semitic origin,<sup>142</sup> adopts a triconsonantal<sup>143</sup> morphology of three letter roots<sup>144</sup> for most of its verbs.<sup>145</sup> From this triconsonant root, an interspersion of prefixes, suffixes, and vowels<sup>146</sup> modify the word to add tense, possession, quantity, and several other grammatical qualifiers and can even change whole meanings of words. Arabic grammar possesses ten verb forms which use these markers to modify root words potentially leading to entirely different definitions. The root of *shari'ah* is as follows with each letter, from right to left, expressing the š, r, ‘ phonemes respectively:

ش ر ع

The Arabic language dictates that affixing the *fat-ha* (َ) diacritic consonant to the top of each of these three roots elucidates the root word's definition.<sup>147</sup> This appears as follows:

شَرَعَ

Crucially, *shari'ah*'s root word means “to begin, start, or undertake, doing something.” Additionally, Arabic grammar asserts that adding the prefix م<sup>148</sup> to the root

<sup>142</sup> Semitic languages include Arabic, Amharic, Tigrinya, Hebrew, and Aramaic.

<sup>143</sup> Also known as triliteral.

<sup>144</sup> Noam Agmon, “Materials and Language: Pre-Semitic Root Structure Change Concomitant with Transition to Agriculture,” *Brill's Annual of Afroasiatic Languages and Linguistics* 2 (2010): 23–79, 47, doi:10.1163/187666310X12688137960669.

<sup>145</sup> There are some exceptions to the general triconsonantal rule, with some quadriliteral verbs.

<sup>146</sup> Arabic vowels are indicated by several diacritics, collectively called *harakat*. These *harakat* are phonemic marks above or below the consonant to indicate the proper pronunciation of the word.

<sup>147</sup> For the linguistically inclined, the root of *shar'iah* with the proper consonants is شَرَعَ.

<sup>148</sup> The م creates the same sound as the letter “m.”

modifies the word to create nouns of place, instrument, or person.<sup>149</sup> *Shari'ah's* root, with the م prefix, means “a project.” This appears as follows:

مشروع

The significance of this linguistic digression stems from *shari'ah's* origination from the Qur'an and its writing. Interpretations of Qur'anic prosody diverge between literalist and contextualist scholars and their respective philosophies. Nevertheless, taking a literalist approach to *shari'ah* leads to a narrow understanding of its definition as “path.” For a word that symbolizes such a weighty part of Islamic thought, a word that apparently governs “all aspects of a Muslim's life,”<sup>150</sup> surely a single narrow definition cannot suffice, especially from a book like the Qur'an that so prizes semantic prosody.<sup>151</sup> Thus, to properly grasp *shari'ah* values, one must understand it as a beginning and an undertaking. And as a beginning and an undertaking, it cannot simply be a path of fixed length, but instead must be interpreted as a project of ceaseless investigation, inquiry, and analysis, a project with a beginning and no end. As such, from the grammatical underpinnings of *shari'ah*, the ability to at least entertain the notion of Income share agreements as in concert with *shari'ah* values begins to unravel. If

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<sup>149</sup> This linguistic idiosyncrasy is best explained through example. The root ka-ta-ba means “to write.” The word “office,” a place where writing typically takes place, uses the Arabic consonants transliterated as m-k-t-b. When the root fa-ta-ha, meaning “to open,” adds the “m” prefix, the definition changes to “key,” which is an instrument for opening. Finally, the root da-ra-sa means “to teach,” which changes to “teacher” (a person who teaches), with the م prefix.

<sup>150</sup> BBC, “Sharia.”

<sup>151</sup> Kholood Al-Sofi, Marlyna Maros, and Kaseh Abu Bakr, “Semantic Prosody in the Qur'an,” *International Journal of Linguistics* 6, no. 2 (2014): 120–31, doi:10.5296/ijl.v6i2.5416.

*shari'ah* is a ceaseless path, it can be assumed that at some point, such a path at least approaches income share agreements.

### ***Shari'ah Values***

The nuance that characterizes *shari'ah* as an Arabic vocabulary term extends further within it as a moral and social code. *Shari'ah* cannot be understood as a single unit but instead is a term encompassing a kaleidoscope of concepts. An academic inquiry into the totality of *shari'ah*, its origins, variations, applications, and the debate surrounding it for centuries, would require the most precise of microtomes to properly encapsulate the magnitude of these nuances, leading to a work of thousands of pages and dozens of volumes. Supplanting such an exegesis with heightened brevity is the aim of this sections.

*Shari'ah* was not the first revelation to the Prophet Muhammad nor was he delivered an explicit regulatory book containing the *corpus juris* of Islam. Rather, “read,” was the first word, delivered as a command, that the archangel Gabriel said to Mohammad as he meditated in the cave of Mount Hira.<sup>152</sup> That the command “read,” was the first revelation to the prophet is significant to the concept of *shari'ah* because of the primacy of reading as a means of attaining knowledge. Both the Quran<sup>153</sup> and

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<sup>152</sup> Muhammad Mustafa Al-A'zami, *The History of the Qur'anic Text: From Revelation to Compilation: A Comparative Study with the Old and New Testaments* (Leicester: UK Islamic Text, 2003).

<sup>153</sup> In the Quran, 20:114 says “Oh my Sustainer, cause me to grow in knowledge!”

hadith oblige Muslims to attain knowledge and engage in constant inquiry, with the Prophet reported to have said “seeking knowledge is a duty upon every Muslim.”<sup>154</sup>

The attainment of knowledge and abhorrence of ignorance is central to *shari’ah* and is among its fundamental moral imperatives. The word *shari’ah* appears only once in the Quran and is set against the word *hawa* as follows:

“We have established for you a code of conduct and a religion. Follow it and do not follow the whimsical desires of the ignorant people.” (45:18)<sup>155</sup>

*Shari’ah* here is translated as a “code of conduct” which should be upheld against the whimsical desires (*hawa*) of ignorant people. So reprehensible are these foolish and whimsical desires that the evils associated with *hawa* are mentioned in the Quran no less than 25 times whereas the term *shari’ah* is only mentioned in this single verse.<sup>156</sup>

*Hawa* acts as a Quranic form of Hobbes’s state of nature. Man, left in the state of nature, will pursue his natural desires and satisfy his animalistic needs leading to the absence of society and civility and an abundance of chaos. Just as Hobbes asserts that pursuit of desire is natural to humans, so does the Quran through this concept of *hawa*. In the case of the Quran, with this singular verse, the solution to *hawa* is presented in

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<sup>154</sup> Muhammad bin Yazid Ibn Majah al-Qazvini, “Hadith - The Book of the Sunnah - Sunan Ibn Majah,” *Sunnah.com*, 2016, <https://sunnah.com/urn/1252230>.

<sup>155</sup> Kais Dukes and Muhammad Sarwar, “The Quranic Arabic Corpus - Translation,” *Corpus.Quran.com*, 2009, <http://corpus.quran.com/translation.jsp?chapter=45&verse=18>.

<sup>156</sup> Mohammad Kamali, *Shari’ah Law: An Introduction* (Oxford: Oneworld Publications, 2008), 15.

the form of *shari'ah* and thus it can be established that the first goal of *shari'ah*, manifested through its moral guidance, is to provide a framework for the avoidance of anarchy and an uncivilized society and the establishment of an educated and ethical civilization.

While the Prophet was not the recipient of an explicitly labeled *corpus juris*, the Quran itself acts as a value system for Muslims from which the beginnings of a legal code have been parsed. This legal code is by no means explicit, with only rare exceptions. The Quran's explicit instructions for *hudud* (punishment), for example, are sparse and must be considered with respect to the societal context in which they were revealed. For the most part, the Quran is "mainly concerned with general principles" of political justice, economic equity, and cohesive community, principles made clear, expressed, and organized according to *shari'ah*.<sup>157</sup> The clear legal refrains contained in the Quran constitute only a small portion of the whole book in contradistinction from the majority of the text's devotion to "Islamic dogma, moral values, man and the universe, the hereafter, and numerous stories and parables."<sup>158</sup> So to argue that *Shari'ah* is solely a legal code is inadequate. Rather, it is a comprehensive paradigm of ethical thinking from which a legal code can be deduced according to the structural framework discussed throughout this chapter.

This imbalance between legal and moral code can be explained according to the causes and circumstances of revelation (*asbab al-nuzul*). Composing a portion of the

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<sup>157</sup> Ibid., 21.

<sup>158</sup> Ibid.



*asbab al-nuzul* (also defined as “context”) is the location of Quranic revelation. Much of the Quran, 85 of the 114 chapters, was revealed in Mecca, gradually and not all at once, while the rest were revealed in Medina.<sup>159</sup> This piecemeal approach to revelation, called *tadarruj* (literally meaning “steps” or “stairs”) meant that the content of revealed verses was dependent upon the circumstances surrounding the Prophet and his companions and means that there is a significant difference between Meccan and Medinan verses. While in the prosperous city of Mecca, the Prophet was subject to significant ridicule and Islam was only in its infancy, with a small group of followers. The explicit rules one would find in a comprehensive legal code were not found in the Meccan verses because a highly technical and specific legal code is of little use to a population with no political power. The Meccan verses instead discuss general religious concepts of morality, responsibility, judgement day, good, evil, ritual prayers, alms giving (*zakat*), and justice to orphans and widows.<sup>160</sup> Meccan verses also “focused on Islam as a faith and structure of moral values” and while here, the Prophet “referred to the Quran as a ‘source of authority’” and only in his later years, after his escape to Medina, did he refer to his own teachings and example (*Sunnah*) as a “guide to conduct.”<sup>161</sup> After having been informed of his impending assassination, the Prophet fled from Mecca to Medina where a Muslim community was established and the proportion of the population following Islam grew rapidly. This necessitated the revelation of more juridical verses in order to accommodate societal needs as they were encountered but even then, it was not until

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<sup>159</sup> Ibid., 3-4.

<sup>160</sup> Ibid.

<sup>161</sup> Ibid.

the last two years of the Prophet's life that the bulk of these legal maxims were revealed.

One important perspective on this geographic (Mecca-Medina) distinction comes from Mahmoud Mohammad Taha, a 20<sup>th</sup> century Sudanese Islamic scholar, who points out that such a distinction underpins an important qualification of what actually constitutes *shari'ah*. Taha's "The Second Message of Islam" asserts that the division between the geographic origins of the Meccan and Medinan verses demonstrates two sets of Islamic values.<sup>162</sup> The first set, revealed in Mecca and more generalist in nature, concerns itself with man's approach to Allah. The second set of rules, smaller in number and more political and juridical in nature, were revealed in Medina. Thus, a literalist interpretation of these texts as opposed to a value-based deduction is only relevant within a 7<sup>th</sup> century Medinan context.<sup>163</sup> Taha posits that 20<sup>th</sup> century jurists "must now elevate legislation by evolving and basing it on the original Qur'anic verses"<sup>164</sup> which constitute a more pure form of Islamic dogma than the pragmatic, clearer, but contextually fixed verses revealed in the Medinan era. Taha's beliefs are steeped in an understanding of an impermanent *shari'ah* which engenders change and update. This impermanence is in accordance with the 13<sup>th</sup> century Islamic scholar, Ibn Qayyim al-Jawziyyah, who refers both to a finite set of Islamic laws "which do not change with the

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<sup>162</sup> Mahmoud Mohamad Taha, "The Second Message of Islam," in *Liberal Islam*, ed. Charles Kurzman (New York City: Oxford University Press, 1998).

<sup>163</sup> Ibid.

<sup>164</sup> The verses he refers to here are those revealed in Mecca.

vicissitudes of time and place” and a larger second set of laws “which are susceptible to change in accordance with the requirements of public interest (*maslahah*).”<sup>165</sup>

## ***Fiqh***

While Taha’s perspective on *shari’ah* follows a unique and contemporary thread of modernist Islamic scholarship<sup>166</sup> and al-Jawziyyah outlines a similar but classical perspective, there are certain *shari’ah* concepts upon which all Islamic scholars agree. The first and most important is the *shari’ah* – *fiqh* distinction.

Thus far, as is common among many Islamic scholars and in the parlance of Islamic commentators, the concept of *shari’ah* is used overwhelmingly and erroneously to refer to Islamic law. However, there exists a more precise term for the *shari’ah* values this paper intends to discuss: *fiqh*. While *shari’ah* is concerned with the concepts conveyed through the divine revelation (*wahy*) of the Quran and *sunnah*<sup>167</sup> of the Prophet, *fiqh* “refers mainly to the *corpus juris* that is developed by the legal schools (*madhabs*), individual jurists and judges by recourse to legal reasoning (*ijtihad*) and issuing of legal verdict (*fatwa*).”<sup>168</sup> The two can be easily distinguished first according to their sources, shown on the following page:

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<sup>165</sup> Kamali, *Shari’ah Law: An Introduction*, 51.

<sup>166</sup> The Sudanese government executed Taha in 1985 for crimes of apostasy.

<sup>167</sup> It is important here to distinguish between *Sunnah* and *Hadith* as, like *fiqh* and *Shari’ah*, the two terms are often used interchangeably. *Hadith* refers to the sayings of the Prophet, i.e. recorded transcripts of conversations or speeches the Prophet gave. *Sunnah*, meanwhile, refers to the methods and actions of the Prophet.

<sup>168</sup> Kamali, *Shari’ah Law: An Introduction*, 3.

Islamic Concept	Components
<i>Shari'ah</i>	Quran + <i>Sunnah</i>
<i>Fiqh</i>	Quran + <i>Sunnah</i> + <i>Ijtihad</i> + <i>Madhabs</i>

Figure 1: Sources of *Shari'ah* vs. *Fiqh*

*Fiqh*, a juristic edifice based on Islamic values, relies on human endeavor and accepts human reason (*aql*) as a basis for understanding and applying practical legal rules (*al-ahkam al-amaliyya*) whereas *Shari'ah* turns exclusively to the Quran and *Sunnah* as vehicles for revelation and encompasses the totality of human behavior.<sup>169</sup> This distinction is meant not so much to denigrate the importance of human reasoning but rather to elevate and affirm “the principle that juristic opinion and *ijtihad*<sup>170</sup> are not to be equated with the authority of divine revelation.”<sup>171</sup>

Bediuzzaman Said Nursi, a 20<sup>th</sup> century Turkish Islamic philosopher, compiled a list of 16 component values of *Shari'ah* in his *Damascus Sermon*. They are as follows: Virtue, Peace, Accord, Justice, Human Progress, Truth, Guidance, Attraction, Harmony, Spiritual Advancement, Unity, Love, Defensiveness, Sincere Brotherhood, Mutual Assistance, and Solidarity.<sup>172</sup> Notice, however, that these are conceptual frameworks whose practical applications are not immediately or apparently clear; the pragmatics of such concepts requires deduction.

<sup>169</sup> Ibid., 16.

<sup>170</sup> *Ijtihad* is defined as independent reasoning.

<sup>171</sup> Ibid.

<sup>172</sup> Kamil Fadel and Eren Tatari, “A Political Analysis of Bediuzzaman Said Nursi’s *Damascus Sermon*,” *Humanities and Social Sciences Review* 5, no. 3 (2016): 303–22, doi:2165-6258.

On the other hand, the practical and actionable decrees enshrined in *shari'ah*, are the ideas held within the five pillars of Islam: these include the declaration of the oneness of God with Mohammad as his Prophet (*shahada*), ritualistic prayer (*salat*), alms giving (*zakat*), fasting during the month of Ramadan (*sawm*), and the pilgrimage to Mecca (*Hajj*) along with a sixth concept, cleanliness.<sup>173</sup> *Shari'ah* is clear on the necessity and centrality of these actions for Muslims.

Furthermore, the equivocal nature of the Quran can be understood as part of the religion vs. juridical binary inherent to Islam. Among the Quran's most widely disseminated verses is that "there is no compulsion in religion".<sup>174</sup> This verse, with respect to the *'ibadat - mu'amalat* distinction (devotional matter – civil transaction), means that only juridical obligations and most explicitly not religious obligations can be "enforceable through formal sanction by the course of justice."<sup>175</sup> *'Ibadat* addresses the vertical relationship between man and his Creator. Such a religious relationship is not to be judged by others, Muslim and non-Muslim alike, according to the Islamic principle of *takfir*. *Takfir*, or the practice of labeling another Muslim as non-Muslim (*kafir*), is heavily forbidden and such a power is available only to Allah. The horizontal relationship between man and his fellow human being or man and his government does fall under the domain of *shari'ah* but it is expressed through *fiqh*. *Fiqh* is the manifestation of

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<sup>173</sup> Vincent Cornell, *Voices of Islam: Voices of Tradition* (Westport: Greenwood Publishing Group, 2007), 150.

<sup>174</sup> "2:256," in *Qur'an*, n.d.

<sup>175</sup> Kamali, *Shari'ah Law: An Introduction*, 17.

Quranic principles in the social and political lives of Muslims and thus *fiqh* can be understood as a component within the broad category of *shari'ah*.

Further qualifying the application of *shari'ah* to civil life is its five-unit scale of values used to determine the permissibility of an action. Human acts are classified as “obligatory (*wajib*), recommended (*mandub*), permissible (*mubah*), reprehensible (*makruh*), and forbidden (*haram*).”<sup>176</sup> Of these, deciding those actions considered obligatory or forbidden requires “clear injunctions of the Quran and Sunnah,” whereas the other three, recommended, permissible, and reprehensible are non-legal and are intended to advance civility in civil society according to human free will.<sup>177</sup> Islam holds free will in extremely high regard. The Quran observes that “Had Allah known any good in them, He would have made them hear. And if He had made them hear, they would [still] have turned away, while they were refusing.”<sup>178</sup> Even if Allah’s voice rings clear to humans, they will still turn away and act independently. While the Quran affirms that Allah can exert control over all, the Prophet was noted to intone, “there is none of you but has his place assigned either in the Fire or in Paradise,” referring to the nonexistence of strict divine decree.<sup>179</sup> Hence, with the exception of that which is *haram* and *wajib*, humans are free to chart their own course through their civil transactions.<sup>180</sup>

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<sup>176</sup> Cornell, *Voices of Islam: Voices of Tradition*, 150.

<sup>177</sup> Kamali, *Shari'ah Law: An Introduction*, 18.

<sup>178</sup> “8:23,” in *Quran*, n.d.

<sup>179</sup> “Volume 8, Book 77, Number 602,” in *Sahih Bukhari, Book 77* (Center for Muslim-Jewish Engagement, University of Southern California), accessed March 15, 2017, <http://www.usc.edu/org/cmje/religious-texts/hadith/bukhari/077-sbt.php>.

<sup>180</sup> Almir Colan, “Sources of Islamic Law” (An Introduction to Islamic Finance with Almir Colan, 2016).

Underneath the umbrella framework of *shari'ah* values, which serves as an Islamic thematic background, one finds *fiqh* which outlines not only the practicalities of the Islam's five pillars, but indeed the practicalities of all actions of Muslims derived from detailed source analysis and human reason. What cannot be explained by clear Quranic injunction and requires any form of human reasoning, consultation, or analysis falls under the domain of *fiqh*. Considering that much of the Quran is expressed through general principles and not through explicit injunction, *fiqh* and its requirement of deep human analysis and consideration stands as an important cornerstone in determining the permissibility of something under Islamic values. Nursi's understanding of *shari'ah* concepts provides a set of very general moral goals of Islamic dogma on issues including "civil transactions (*mu'amalat*), criminal law, government policy and constitution, fiscal policy, taxation, economic affairs, and international affairs."<sup>181</sup> That is to say, the manifestation of these concepts is required to adhere to *shari'ah* principles but the means of enacting and executing policy relating to them falls under the domain of *fiqh*. *Fiqh* dictates, for example, the necessity of five daily prayers instead of the three explicitly mentioned in the Quran, a conclusion based on human analysis and understanding of *shari'ah*.<sup>182</sup>

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<sup>181</sup> Ibid., 41.

<sup>182</sup> 24:58 mentions the dawn and night prayer with a middle prayer mentioned in 2:238. Thus it would appear that the Quran dictates three prayers. *Shari'ah* simply obligates humans to prayer as prayer is mentioned as a requirement in the Quran. However, a textual analysis of these three verses in conjunction with one another has led to the longstanding tradition of five daily prayers. This analysis and application of human reasoning to divinely decreed Quranic injunctions is an example of *fiqh*.

Within *fiqh* is a major distinction between devotional matters (*'ibadat*) and civil transactions (*mu'amalat*), along with analyses of crime and penalties (*al-'uqubat*), constitutional and state law (*al-ahkam al-sultaniyyah*), and *'ilm al-siyar* which encompasses international relations, war, and peace.<sup>183</sup> Much of *fiqh* that relates to *'ibadat* is satisfied within explicit *shari'ah*; that is, there exist clear injunctions within Quran and *Sunnah* mandating specific actions for Muslims to take. However, the absolute nature of these injunctions does not necessarily answer all minutiae associated with how and why such actions are to be performed. To answer these questions human ratiocination is required, ratiocination which moves these requirements from the realm of *shari'ah* to that of *fiqh*.

Within *fiqh*, the category of greatest relevance to this paper and to Muslims as a whole is that of *mu'amalat*.<sup>184</sup> *Mu'amalat* is studied generally under the seven headings of transactions as follows: (1) exchange of values (a concept encompassing contract law and commerce), (2) matrimonial law, (3) equity, (4) trusts, (5) civil litigation, (6) rules pertaining to dispute settlement in courts, and (7) administration of estates (a concept encompassing inheritance law).<sup>185</sup>

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<sup>183</sup> Ibid., 42.

<sup>184</sup> Like all religions, Islam cannot be seen as a monolith and the methods by which Muslims express their religiosity vary just as much as they do in Christianity and Judaism. Much in the same way that Christians and Jews identify as culturally Christian or Jewish, so do many Muslims. The Quran specifically outlines that "there is no compulsion in religion" (2:226), indicating that devotional matters are of private nature. Civil transactions, however, are considered by legislative *shari'ah* and are of relevance to this jurisprudential discourse. For example, Muslim who does not pray five times a day still may want to finance their home or procure an Income Share Agreement according to Islamic principles.

<sup>185</sup> Ibid.



All eight of the major schools of jurisprudence<sup>186</sup> agree with the classification system of *shari'ah* themes outlined thus far, with only minor exceptions.<sup>187</sup> So far, this classification system is expressed simply as follows:

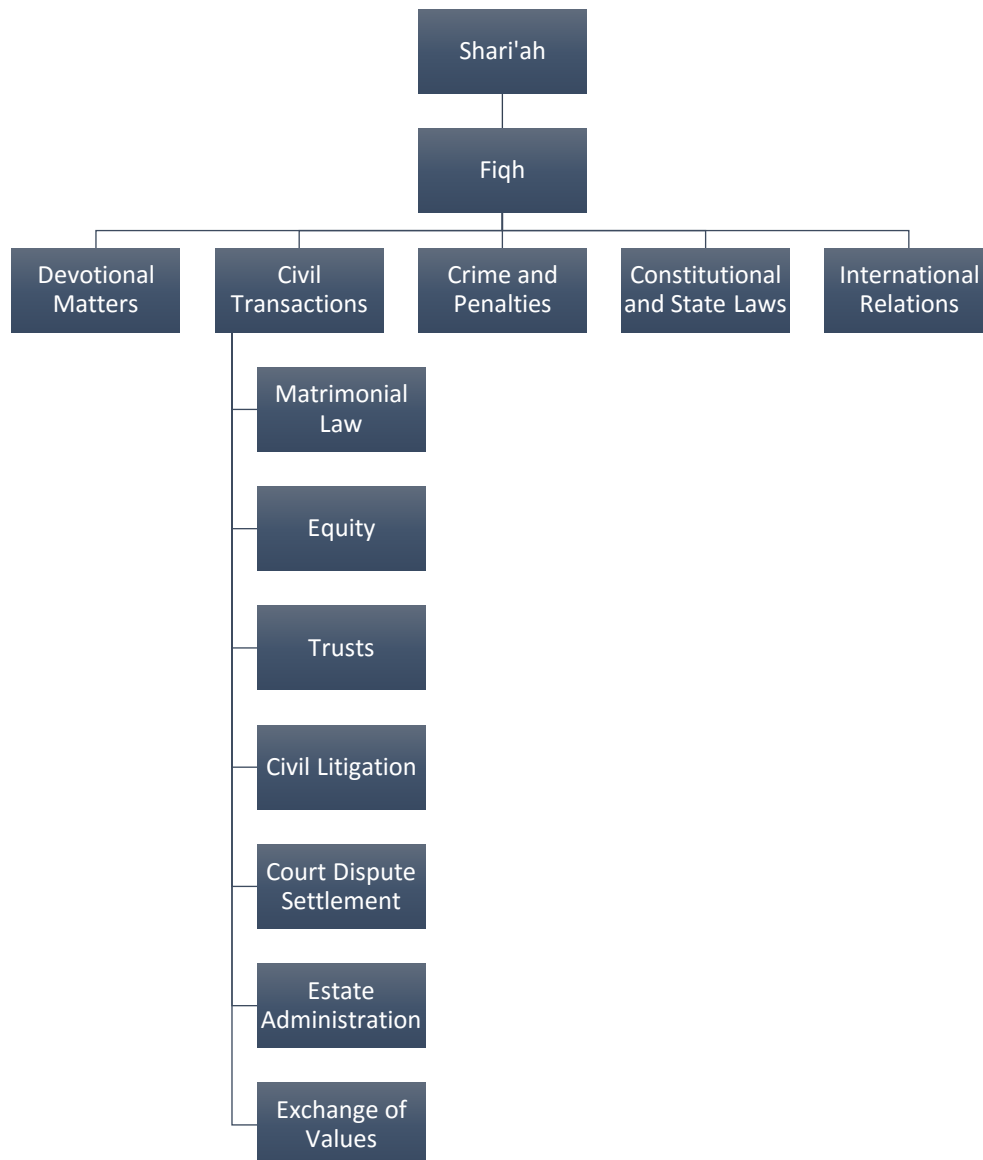


Figure 2: Shari'ah Framework

<sup>186</sup> The eight major schools of Islamic jurisprudence include four Sunni schools, the Hanafi; Hanbali; Maliki; and Shafi'i, two Shi'ite schools, Ja'fari and Zaidi, along with the much smaller Ibadi and Zahiri schools.

<sup>187</sup> Ibid., 10.

Additionally, the schools of jurisprudence agree on the fundamental nature of Quran and *Sunnah* to the foundation of *shari'ah*.<sup>188</sup> Where disagreement exists is the degree to which other sources or methods of determining Islamic Law are taken into consideration to, through *fiqh*, interpret and apply the moral code of *shari'ah*. While the Quran provides a bedrock of Islamic values whose understanding and analysis is aided by the *Sunnah* of the Prophet, the totality of *shari'ah* could not simply be explained by jurists or comprehended by citizens through reading the Quran.

The vagueness of the Quran is intentional because of its status as a transcendental text whose moral and theological maxims are supposed to withstand the tests of time. Its lack of specificity provides an intentionally timeless character to the laws which are to be sourced from its values. Where the Quran and *Sunnah* do not provide clear justiciable injunctions, man must intervene. After the Quran and *Sunnah*, *shari'ah* is sourced from human reasoning (*ijtihad*), analogical reasoning (*qiyas*), juristic preference (*istihsan*), presumption of continuity (*istishab*) and general consensus (*ijma*).

The succession of *shari'ah* sources from more foundational to less foundational is as follows: clear verse in the Quran, supporting verses elsewhere in the Quran, *Sunnah*, rulings by companions of the prophet, later commentators, *ijtihad* or *istihsan*, *ijma*, *istishab*, and *qiyas*.<sup>189</sup> The most controversial and simultaneously most crucial of

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<sup>188</sup> Ibid., 19.

<sup>189</sup> "Later commentators" are those members of the professionally educated Islamic academic class, the *ulama*, who devoted their lives and careers to Islamic inquiry.

these other sources of *shari'ah* is *ijtihad*, whereas *qiyas* and *ijma* are the least disputed.<sup>190</sup>

*Ijtihad*'s controversy overrides those of the successive forms of jurisprudential inquiry because of its foundational nature to all successive methods of Islamic inquiry. Independent reasoning is the first and foremost step taken in elucidating exactly what is acceptable under *shari'ah* values. *Ijtihad* requires human beings to levy judgement in the absence of clear injunctions from Allah (God).<sup>191</sup> Doing so must be done with tact because it can be seen by many conservative jurists as approaching Islam's cardinal sin, *shirk*. One who commits *shirk* is one who attributes the omnipotence and omniscience of Allah to anything other than Allah. The magnitude of importance attributed to *tawhid* (the oneness of Allah) as the first pillar of Islam is balanced by the weight of *shirk* as an opposite sin. The Quran spells it out clearly as follows:

"God will not forgive the sin of considering something equal to Him, but He may forgive the other sins of whomever He wants. One who considers anything equal to God has certainly gone far away from the right path."<sup>192</sup>

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<sup>190</sup> Ibid., 19.

<sup>191</sup> Muslims consider the God of Christianity and the *Yahweh* of Judaism to be the same God of Muslims. *Allah* is simply an Arabic term referring to the same God that Christians and Jews refer to and the Quran mentions with great frequency the followers of these religions to be *Ahl al-Kitab*, people of the book.

<sup>192</sup> "4:116," in *Quran*, n.d.

Here, the phrase “considering something equal to him” is translated from the Arabic term *shirk*. So abhorrent is improper *ijtihad*, according to fundamentalist circles of Islamic inquiry, that it is tantamount to assuming the role of God and committing of *shirk*.

Nevertheless, the role of *ijtihad* in *shari’ah* cannot be understated and despite potential critiques by some Islamic scholars, it remains fundamental to Islam and *shari’ah*.<sup>193</sup> As mentioned previously, pursuit of knowledge is an immutable cornerstone of Islam and the first receiver of any new knowledge is tautologically the learner. And this learner, with any and all information, must pass judgement on it to make decisions as banal as avoiding a suspicious arachnid or as significant as issuing a new *fatwa* (ruling by Islamic scholar). The first set of judgments an individual makes are independent judgments and it is upon these independent judgments that decisions are made. Herein lies a link, between knowledge and the action taken on behalf of that knowledge, that is so prominent that Imam Shafi’i, whose teachings eventually inspired the Shafi’i school of Islamic jurisprudence (*madhab*), stated that “knowledge without action is arrogance.”<sup>194</sup>

As *ijtihad* is a function of reason, the process of ratiocination (*ta’lil*) is vital. The hadith narrated by Mu'adh ibn Jabal demonstrates the centrality of ratiocination and thus *ijtihad*. Ibn Jabal was asked by the prophet to travel to Yemen to spread the teachings of Islam. Prior to his departure, the Prophet asked ibn Jabal “how will you

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<sup>193</sup> The hypocrisy by small circles of Islamic jurists who employ *ijtihad* to decide that *ijtihad* is unforgivable does not escape the author.

<sup>194</sup> Clint Jones and Cameron Ellis, *The Individual and Utopia: A Multidisciplinary Study of Humanity and Perfection* (New York: Routledge, 2016), 271.

judge when the occasion of deciding a case arises?" Ibn Jabal replied that, in the absence of clear guidance from the Quran and *Sunnah*, he "shall do [his] best to form an opinion and [that he would] spare no effort." The Prophet, noting his reply, "patted him on the breast" and warmly approved.<sup>195</sup> Ibn Jabal's exercise of forming a jurisprudential opinion constitutes *ijtihad* and the Prophet's praise of it comes as no surprise since the Quran affirmatively mentions on numerous occasions the valor of "those who think, who exercise their faculty of reason, who enquire into the world around them and investigate, who possess knowledge, and who draw rational conclusions."<sup>196</sup> The Quran emphasizes repeatedly the need for evidence and independent reasoning when deciding on matters.

"And do not follow the knowledge of which you are not certain of. Indeed, the hearing, the sight and the heart - about all those [one] will be questioned."<sup>197</sup>

Earlier in the Quran Allah instructs Muslims to not blindly follow information whose veracity is not certain.

"... Say: produce your proof if you should be truthful."<sup>198</sup>

This verse, referring to those who say only Christians or Jews can enter heaven, nonetheless requires evidence in order to validate a statement.

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<sup>195</sup> Hadith Collection, "Abu Dawud Book 018, Hadith Number 3585," *Hadith Collection*, 2016, [http://hadithcollection.com/abudawud/250-Abu Dawud Book 18. The Office Of The Judge/17580-abu-dawud-book-018-hadith-number-3585.html](http://hadithcollection.com/abudawud/250-Abu-Dawud-Book-18-The-Office-Of-The-Judge/17580-abu-dawud-book-018-hadith-number-3585.html).

<sup>196</sup> Kamali, *Shari'ah Law: An Introduction*, 54.

<sup>197</sup> "17:136," in *Quran*, n.d.

<sup>198</sup> "2:111," in *Quran*, n.d.

“Will they continue to follow their forefathers even though their forefathers might have known nothing, and might have been on the wrong way? Believers! Take heed of your own selves. If you are rightly guided, the error of he who strays will not harm you”<sup>199</sup>

The Quran disqualifies the appeal to authority by negating blind adherence to “forefathers” when deciding whether to continue worshipping idols. Instead of solely relying on the actions and instructions of forefathers, Muslims are responsible for their own independent actions and must exercise their rational faculties to reach a decision.

The Quran also gives validity to analysis of the effective causes (*'illah*) and underlying reasons (*hikmah*) of the injunctions it mandates.<sup>200</sup> Inherent to a rational view of the Quran is inquiry into the cause and effects of particular rulings and thus the Quran can be seen as a text which espouses critical analysis and ratiocination.

Combining this emphasis on *ta'lil* (ratiocination) with its requisite examination of *'illah* (effective cause) and *hikmah* (underlying reason), it is a natural conclusion that literalist interpretations of the text are impermissible or at the very least, irrational. Despite this, one school of thought persisted, the Zahiri, which found ratiocination and much of *ijtihad* to be indulgent and in contradistinction from the will of Allah. Of the mainstream *madhabs*, however, the Zahiri school exists very minutely and remotely, with many mainstream scholars concluding its extinction having been effective since the 14<sup>th</sup>

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<sup>199</sup> “5:104-105,” in *Quran*, n.d.

<sup>200</sup> *Ibid.*, 54.

century C.E. Their disappearance reinforces the value Islam and Islamic inquiry imparts on *ta'lil*.<sup>201</sup>

## ***Shari'ah Protections***

With rationality as a foundational principle, *shari'ah* decrees the existence of five human interests which it aims to protect: religion, life, intellect, lineage, and property.<sup>202</sup> First is religion, whose sanctity and freedom of belief *shari'ah* intends on safeguarding according to the Quranic principle outlined in 2:256.<sup>203</sup> Second, *shari'ah* seeks to uphold an honourable life which entails the liberal principles of “freedom to work, freedom of speech, and freedom of travel.”<sup>204</sup> Third is the protection of the intellect. With *ta'lil* (ratiocination), *ijtihad* (independent reasoning), and *ijma* (consultation) so vital to the process of *shari'ah* legislation, the need for an educated and intellectual society able to reason and debate solutions to its contemporary issues is vital to any Islamic code. Fourth is the aim of safeguarding the purity of lineage. The general directives of Quran and *Sunnah* are meant to be passed from generation to generation. Commensurately, the creation of legal maxims intended to evolve according to the needs of society is part of *shari'ah* and for this constant evolution to take place,

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<sup>201</sup> John Esposito, “Zahiri,” in *The Oxford Dictionary of Islam* (Oxford: Oxford University Press, 2003).

<sup>202</sup> Mashhad Al-Allaf, “Islamic Divine Law (Shari'ah): The Objectives (Maqasid) of the Islamic Divine Law Or Maqasid Theory” (Islamic Philosophy Online), accessed March 5, 2017, <http://www.muslimphilosophy.com/ma/works/maqasid.pdf>.

<sup>203</sup> “There shall be no compulsion in religion.” (2:256).

<sup>204</sup> Kamali, *Shari'ah Law: An Introduction*, 31.

*shari'ah* works to create a “favourable environment for the care and custody of children.”<sup>205</sup>

Fifth, finally, and most germane to the inquiry of this research is *shari'ah's* deliberate approach to protecting property. Islam has a long relationship with commerce and trade, starting with its origins in the Hejaz, the Western coast of Saudi Arabia encompassing Mecca, Medina, and Jeddah. Geographically, this region was of significant importance because it sits at the nexus of East Africa (with its once thriving Nubian Empire), Asia, and Europe. Thus, for each of these three regions to trade with one another, merchants would naturally need to pass through the Hejaz, engendering its pre-Islamic citizens with commercial culture. Beyond a geographic and situational experience with commerce, there exists a historic connection between Islam and business. Khadija bint Khuwaylid, Islam's first female follower, the Prophet's first wife, and the first Muslim after the Prophet himself, was also a woman of tremendous wealth sourced from a prosperous network of trade caravans.<sup>206</sup> Thus, religious motivations aside and from a purely pragmatic perspective, Islam needed a robust commercial code protecting ownership and a just system of exchanging goods and services in order to maintain the commercial culture within which it was founded.

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<sup>205</sup> Ibid., 34.

<sup>206</sup> Muhammad ibn Saad, *The Women of Madina*, ed. Aisha Bewley, *Tabaqat*, vol. 8 (London: Ta-Ha Publishers, 1995), 10.



## ***Shari'ah Foundational Value***

In addition to these five human interests, *shari'ah* identifies as its foundational value the concept of mercy, which is expressed through three components: education, justice, and public benefit.<sup>207</sup> Indeed the civil transaction section of *shari'ah* (like all other sections) can be understood as a pragmatic realization of divine mercy. Mercy is a recurring theme in the Quran, with each prayer and every chapter beginning with “*Bismillah al-Rahman al-Rahim*,” which means “in the name of God the most gracious and most merciful.” The whole mission of the Prophet was not necessarily to spread Islam, but rather to act as a vessel for Allah’s mercy, described in 21:107 where Allah addresses the Prophet by saying “And We have not sent you, [O Muhammad], except as a mercy to the worlds.” Mercy, as a concept, is conveyed as an Allah-to-human action with triplicate objectives of (1) educating humanity, (2) establishing justice, and most importantly (3) realizing benefit for all people.<sup>208</sup>

Of these three, there exists a distinction with education as somewhat separate from justice and public good. This distinction is one of foundational *shari'ah* versus executable *shari'ah*. Education is a foundational prerequisite of *shari'ah* for without a properly educated intelligentsia and community, the methodologies of *shari'ah* consideration (independent reasoning, consultation, judicial preference, etc.) are easily liable to corruption or ignorance. Justice and public good, the judgement of which is decided thanks to a robust education system, are the ways through which Allah’s mercy

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<sup>207</sup> Kamali, *Shari'ah Law: An Introduction*, 30.

<sup>208</sup> Ibid.

is put into action and manifested in society and justice and public good are two components indivisible from one another. Ibn Al-Qayyim, a 14<sup>th</sup> century Islamic scholar and among the Hanbali school of jurisprudence's most important figures, said the following about *shari'ah*:

“Verily, the Sharia is founded upon wisdom and welfare for the servants in this life and the afterlife. In its entirety it is justice, mercy, benefit, and wisdom. Every matter which abandons justice for tyranny, mercy for cruelty, benefit for corruption, and wisdom for foolishness is not a part of the Sharia even if it was introduced therein by an interpretation.”<sup>209</sup>

Ibn Al-Qayyim reinforces the *shari'ah* mandate for maximizing good, in the form of justice; mercy; benefit; and wisdom, and minimizing harm in the form of tyranny; cruelty; corruption, and foolishness. The purpose of the maximization of these virtues and the minimization of the vices al-Qayyim discusses are for the public good.

As discussed previously, *shari'ah* outlines in part the duties of an individual to his Creator through the six obligations of cleanliness, declaration of the oneness of God with Mohammad as his Prophet, ritualistic prayer, alms giving, fasting during the month of Ramadan, and the pilgrimage to Mecca. However, these make up the minority of *shari'ah* and besides, are unenforceable in court according to Islam's injunction that

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<sup>209</sup> Abu Amina Elias and I'lam al-Muwaqqi'in, "Ibn Al-Qayyim on Law: The Sharia Is Based Upon Justice, Mercy, Welfare and Wisdom," *Daily Hadith Online*, 2012, <http://dailyhadith.abuaminaelias.com/2012/07/07/ibn-al-qayyim-the-sharia-is-based-upon-justice-mercy-welfare-and-wisdom/>.

there is no compulsion in religion. What is enforceable are the horizontal relationships individuals have with each other and their government. As a result, private matters are of less importance than public good and it is public good, *maslahah*, and the consideration of public good, *istislah*, which stands as the ultimate bright line for determining *shari'ah* compliance.

The public good is of such utmost importance that it can be used as a stand-in for justice. What is just in a society is what engenders public good maximally. This highly pragmatic perspective of *shari'ah* is confirmed by Imam Malik, an 8<sup>th</sup> century Medinan Islamic scholar, who, for example, ruled that it is permissible for a less qualified leader to lead a state over a more qualified leader so long as the less qualified leader better galvanizes public good.<sup>210</sup> In addition to Imam Malik's ruling, Kamali describes another legal maxim which decided that "instances of conflict between public and private interests must be determined in favor of public interests."<sup>211</sup> These examples apparently contradict one of the earlier mentioned aims of *shari'ah*, to convey mercy as education, but prioritizing public good doesn't diminish education's importance so much as it shifts the scope of rationality, justice, and what is being educated to a paradigm that wholly favors public good. Rationally, the most qualified leader to lead likely has the best education or would be favored by the most educated members of a community. But

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<sup>210</sup> Cornell, *Voices of Islam: Voices of Tradition*, 169.

<sup>211</sup> Mohammad Hashim Kamali, "Law and Society: The Interplay of Revelation and Reason in the Shariah," in *Oxford History of Islam*, ed. John Esposito (Oxford: Oxford University Press, 2000), [http://acc.teachmideast.org/texts.php?module\\_id=2&reading\\_id=210&sequence=9](http://acc.teachmideast.org/texts.php?module_id=2&reading_id=210&sequence=9).

these rationalist standards are of ultimately less import than a leader who will provide the greatest benefit for their community.

### ***Maslahah: Public Good***

Of the three means through which Allah transmits mercy through *shari'ah*, education, justice, and public good, it is *maslahah* which must be scrutinized first and the standards of justice are determined vis-à-vis public good. No amount of education is sufficient to promulgate a just society if that education is not aimed at legislation that furthers the public good.

What constitutes public good (*maslahah*) is classified according to three distinctions: essentials (*daruriyyat*), complementary (*hajiyyat*) and embellishments (*tashniyyat*).<sup>212</sup> Essential benefits are tantamount to the bottom levels of Maslow's hierarchy of needs. These include sustenance, shelter, and *shari'ah's* five foundational necessities of religion, life, intellect, lineage, and property. Complementary benefits are those whose absence leads to difficulty but not the "total disruption of normal life."<sup>213</sup> Embellishment benefits are those whose existence improves life after the above basic needs are met.<sup>214</sup> In concert with the highly pragmatic perspective of public-good based *shari'ah* legislation, there must be genuine (*haqiqiyyah*) benefits associated with

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<sup>212</sup> Kamali, *Shari'ah Law: An Introduction*, 33-34.

<sup>213</sup> Ibid.

<sup>214</sup> Ibid.

passage of a proposal, benefits determined from a reasoned and educated perspective and not one steeped in plausibility (*wahmiyyah*).<sup>215</sup>

*Shari'ah* ostensibly is a complex machine with numerous interconnecting parts. At its core, however, it is a moral code which is understood according to *fiqh* and with the ultimate goal of engendering public good. Its tenets of justice, equity, and community are all coloured under a lens of public good. Determining this public good is completed through the exercise of *ijtihad* (independent reasoning) starting in the Quran and *Sunnah* and continuing with an analysis of the prior scholarship of judges and academics alike, searching for evidence through analogy, and consulting with others to determine consensus. The value *shari'ah*'s ascribes to the exercise of rationality also serves as a well for potential controversy. The induction used to first, deduce particular meanings from Quran, *Sunnah*, and prior Islamic sources, and second, apply those to contemporary society, can be done with endless surreptitious motivations. Despite *shari'ah*'s injunction that public good is the ultimate goal and what benefits an individual and harms society is to be avoided, an individual's exercise of *ijtihad* can lead to rulings (*fatwas*) that are clearly harmful.

With this potential for *ijtihad* abuse in mind, this paper will now provide an analysis of the degree to which income share agreements conform to the *shari'ah* principle of engendering maximal public good.

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<sup>215</sup> Mohammad Hashim Kamali, "Have We Neglected the Shari'ah Law Doctrine of Maslahah," *Islamic Studies* 27, no. 4 (1988): 287–303, <http://www.jstor.org/stable/20839910>.

## Shari'ah Compliance of Income Share Agreements

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This section analyzes the degree to which Income Share Agreements are compliant with *Shari'ah*. This will naturally require the use of *ijtihad*, independent reasoning, to determine whether income share agreements fulfill the *maqasid* (goal) of *shari'ah*: *maslahah*, or the engendering of public good and/or avoidance of societal harm. In addition to the employment of *ijtihad*, the method of *qiyas*, analogical reasoning, will be applied to several Islamic financial tools to determine under which umbrella system Income Share Agreements find their closest analogue. Islamic finance is a contractual science with every contract and investment scrutinized for the degree to which it is corrupted by *gharar* (uncertainty and deception), *maisir* (attainment of wealth by chance), and finally, *riba* (usury). Thus, three main questions will be asked to determine whether Income Share Agreements conform to the Islamic principles codified in *shari'ah*:

1. To which analogue in contemporary Islamic finance do Income Share Agreements most closely adhere?
2. Do contracts for Income Share Agreements suffer from any of the corruptors of Islamic contracts, *gharar*, *maisir*, or *riba*?
3. Do Income Share Agreements engender public good or avoid harm?

Finding an analogue in contemporary Islamic finance demonstrates the possibility for *shari'ah* compliance, ensuring *gharar*, *maisir*, and *riba*, are not inherent to income share agreements further evinces this compliance, and satisfying its public good consummates the compliance of income share agreements with *shari'ah*.

## ***Islamic Finance Analogue***

*Shari'ah* is a value system which affords liberty for all except for that which is deemed *haram* (forbidden) or that decreed *wajib* (obligatory). The *shari'ah* brightline for devotional matters, *ibadat*, is the existence of clear decrees in the Quran and *Sunnah*. For *mu'amalat*, civil matters, the brightline by which something is decreed in compliance with *shari'ah* values is the degree to which it affects public good. The maintenance and protection of property, a goal of *shari'ah* which ostensibly appears individual in nature, is actually quite communal and part of upholding the public good. A community is made up of individuals relying on one another through some transaction that may or may not necessarily require an exchange of fiat currency. Ensuring that these exchanges do not devolve into tools of oppression, tyranny, corruption, and cruelty is at the crux of Islamic finance.

Islam, with a rich commercial history, has developed many financial tools to simultaneously satisfy its inherently socialist tenets with the capital requirements of individuals and corporations to ensure that the public as a whole is not subjected to the tyranny of a powerful few, particularly through finance. Considering that acquisition of finance is inherently and at minimum a bilateral agreement, these Islamic financial tools exist under the umbrella of Islamic contracts, called *Uqud*.<sup>216</sup> Notable forms of *uqud* include *Murabaha*, *Ijarah*, *Musharakah*, *Sukuk*, and *Mudarabah*. No matter the contract mechanism selected, all forms of Islamic finance aim to encourage entrepreneurship,

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<sup>216</sup> *Uqud* is the plural form of a single Islamic contract, known as *aqad*.

mutual cooperation, and a spirit of partnership between two parties.<sup>217</sup> Such partnership necessarily entails equitable risk distribution such that inequality among contracting parties does not foster tyranny.<sup>218</sup>

### ***Islamic Contracts***

Islamic contracts must reinforce Islam's values of justice, mercy, benefit, and wisdom and cannot violate its adherents' equitable access to religion, life, intellect, lineage, and property. The Quran outlines with scrupulous detail the nature of a contract, especially in Chapter 2, *Surat Al-Baqarah*. Contracts are to be written down, "O you who have believed, when you contract a debt for a specified term, write it down,"<sup>219</sup> and no matter the circumstances even if someone is too "weary to write it, whether it is small or large, for its [specified] term," it must be recorded physically.<sup>220</sup> Contracts also require witnesses and these witnesses are to never be harmed in any dispute for harming a witness is a "grave disobedience in you."<sup>221</sup> Running in the background of all commerce, the Quran reminds that no matter the nature of any human transaction, "to Allah belongs whatever is in the heavens and whatever is in the earth" and that whatever individuals show publicly or conceal, "Allah will bring you to account for it."<sup>222</sup>

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<sup>217</sup> Almir Colan, "What Is Islamic Finance?" (Islamic Finance with Almir Colan, 2016), <https://itunes.apple.com/ca/podcast/islamic-finance-almir-colan/id569462639?mt=2>.

<sup>218</sup> Rakaan Kayali, "Sukuk on Trial" (Practical Islamic Finance Podcast, 2015).

<sup>219</sup> "2:282," in *Quran*, n.d.

<sup>220</sup> Ibid.

<sup>221</sup> Ibid.

<sup>222</sup> "2:284," in *Quran*, n.d.



Contracts require several components to be deemed valid, or *sahih* as opposed to invalid, *fasid*. Contracts require the following according to Spoors:<sup>223</sup>

(1) Offer and acceptance

Simply, what is offered and the existence of an explicit offer and agreement must be made clear. The offer is must be firm and binding once acceptance is confirmed. The involved parties, for the contract to be valid, must agree fully to the terms and conditions of the offer.

(2) Unity of *majlis*

A *majlis* (session or meeting) must be convened between contracting parties for a contract's validity.

(3) Plurality of the parties

All parties involved in the contract are indeed involved and are not involved through some intermediary. Conversely, should an intermediary be participating, they do so with explicit permission from their superior.

(4) Sanity of contracting parties

All parties involved must possess sufficient mental capability of understanding the nature of a contract. Should all be of sufficient mental capability, they should also be of sufficient educational attainment in order to fully grasp the contents of the contract.

(5) Subject matter susceptible to delivery

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<sup>223</sup> Tom Spoors, "Business Law Under Islam," in *Islamic Finance* (Lulu.com, 2014), 64–70.

The contract must contain specifically what is to be exchanged, its value, utility, deliverability, and its current state of ownership.

(6) *Mahall* (object) defined

What is traded must indeed exist and is not subject to irrational conjecture or chance. This forbids short selling investments, for example.

(7) Beneficial nature of the object

What is exchanged through the contract is not to be forbidden under Islam.

This includes items related to pork, alcohol, prostitution, or gambling.

An income share agreement complies *ad oculos* with nearly all of these above tenets but requires further analysis to confirm its *sahih* nature, an analysis that follows later in this chapter. A student approaching an investor does so with a firm offer that, should the terms of the contract be agreed upon, the contract will follow. Conversely, the investor agrees to the contract assuming its terms are satisfactorily outlined.

The unity of *majlis* and plurality of parties is satisfied when students and investors alike negotiate and physically sign their contracts. As the contract is very likely to be facilitated by an attorney or intermediary financial firm, there is no chance that a student is, by surprise or without their consent, party to the contract.

The sanity of contracting parties is a tenet which can be assumed but also must be enshrined in the contract. Most clearly, the payments under several different income levels and for several different durations must be made clear to ensure an Income Share Agreement's compliance with *uqud sahih* (valid Islamic contracts). Furthermore, alternative payments schemes must be made clear to the student under a traditional

student loan with contemporary interest rates. Both of these characteristics as required components of an income share agreement are outlined in Senator Marco Rubio's proposed Investing in Student Success Act of 2015.<sup>224</sup> Considering this is the most comprehensive and complete legislation proposed to regulate income share agreements, it can be assumed that any income share agreement has been tailored to satisfy this Bill's legislative mandates. Unfortunately, congressional intransigence led to the bill's tabling during the 2015 congressional session. Sufficient private interest in income share agreements likely will revive the bill to finally provide a legislative framework for American income share agreements.

An income share agreement specifies the exchange of a percentage of a student's future income for financing of their current educational demands. This future income is at a specified rate and the percentage of income shared is entitled to the investor. While the deliverability of future income is not fully assured, it does possess a realistic potential of attainment reflected in the risk-adjusted rate applied to the student's future income. *Maisir* and *gharar*, attainment of wealth by chance and uncertainty respectively, are the conditions against which the "*mahall* (object) defined" stipulation of Islamic contracts protects. The avoidance of *maisir* and *gharar* along with the beneficial nature of income share agreements will be discussed later in this chapter.

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<sup>224</sup> Marco Rubio, *S.2186: Investing in Student Success Act of 2015* (Washington DC: Senate, U.S. Congress, 2014), <https://www.congress.gov/114/bills/s2186/BILLS-114s2186is.pdf>.

## Murabaha

The first of the Islamic contracts to be discussed is *Murabaha*, a deferred payment sale. Under *murabaha*, Islamic banks provide their customers credit by buying the goods desired from their client's vendor and reselling them to the client on a deferred payment basis. The ownership title is transferred immediately despite the ongoing payments so that the client can sell the ware.<sup>225</sup> For example, Bob's Halal Burgers requires credit to purchase halal hamburger meat from Hashem's Halal Meats. Bob's Halal Burgers approaches Mike's Islamic Bank for a *murabaha* contract. Mike's Islamic Bank purchases the halal hamburger meat from Hashem's Halal Meats for \$10,000.00 and delivers the product to Bob's Halal Burgers. Bob's Halal Burgers agrees, on a deferred payment basis, to pay back the bank \$10,500. Because the extra \$500.00 paid to Mike's Islamic Bank does not grow of its own accord, is fixed, and is a predetermined profit unlike the interest which grows continuously on debt, such a transaction does not incur *riba* or usury. While such a deferred payment is not analogous to an income share agreement, components of it can be used to understand the conceptual compliance of income share agreements with *shari'ah*. There exists an element of risk sharing between the two parties. While a bank is certain to exercise their due diligence over the profitability and cash flows of a firm, there is an inevitable risk that the transferred product will not provide sufficient capital to the client to repay the bank. Understanding and accepting this risk, the bank proceeds with the transaction and

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<sup>225</sup> Rakaan Kayali, "Analyzing Murabaha, Halal or Haram?" (Practical Islamic Finance Podcast, 2000).

it is in the bank's interest that the product is successfully sold. When the customer wins, the bank wins. Income share agreements similarly intertwine the interests between agents and such aligned incentives underpin all forms of Islamic finance.

### Ijarah

*Ijarah* is comparable to rent-to-own or lease partnerships and is frequently used in the stead of typical home mortgages. A home-seeker will approach a bank with the desired home. The bank agrees to purchase the home for the buyer and sell equity in the home back to the home buyer. As these contracts usually last at least several decades, the homebuyer agrees to pay rent to the bank for the equity portion of the home that is being utilized but is not owned by the buyer. Unlike *murabaha*, in *ijarah* the ownership title is transferred at the end of the payment term, not at the beginning. This means that the renter is not able to sell the underlying asset without permission of the actual owner, the bank. Ownership of the leased or rented item is transferred slowly with each monthly payment.<sup>226</sup> Equity is an important concept in Islamic finance and under *ijarah*, a renter and a financier agree to a gradual equity transfer scheme.<sup>227</sup> Among mortgages and *ijarah* alike, every monthly payment is split in part between profit for the lender and principal for the underlying asset. Under mortgages, however, a greater portion of each monthly payment is applied to interest with less applied to the

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<sup>226</sup> Ahmad Mudahir Omar, "Seminar on Islamic Finance: An Overview of Shariah Contract Practice in Malaysian Islamic Banks" (Kuala Lumpur, 2010), <http://www.bankislam.com.my/en/Documents/shariah/AnOverviewOfShariahContractPractice.pdf>.

<sup>227</sup> Rakaan Kayali, "Critiquing Rent-to-Own (Ijarah Muntahiya Bitamleek) and Diminishing Partnership (Musharakah Mutanaqisa)" (Practical Islamic Finance Podcast, 2000).

principal, thereby allowing interest payments to diminish at a slower rate and equity stake in the home to similarly be acquired at a slower rate. With *Ijarah*, one's monthly payment is split between a figure applied to one's "rent" of the house and another to the purchase of equity in the home. The bank profits off the rent portion of each monthly payment. As the *Ijarah* progresses, the renter purchases more and more equity in the home and pays less and less for the use of the unowned portions of the asset, eventually culminating in the total transfer of ownership once the whole of the principal is paid. Again, unlike interest, the extra payment on top of the principal is fixed at a predetermined figure between the contracting parties.

*Ijarah* is not an analogue to income share agreements but its underlying component of avoiding the use of interest and mutual benefit are components that must similarly exist within an income share agreement.

### Musharakah

Closely related to *ijarah* is *musharakah*, also known as an equity partnership or joint venture. Parties entering a *musharakah* partnership agree to endeavor in some commercial enterprise with profits and losses shared at an agreed upon proportion stemming from each party's capital contribution.<sup>228</sup> Should the commercial enterprise fail, both parties incur a loss and are thus both heavily motivated toward its success. This differs from traditional loans wherein a bank is still entitled to its potential profits despite a business's failure and that bank possesses significant leeway in ensuring the

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<sup>228</sup> Islamic Banker, "Five Main Contracts in Islamic Finance," *IslamicBanker.com*, 2017, <https://www.islamicbanker.com/education/the-five-main-contracts-on-islamic-finance>.

attainment of their profits, even if it means bankrupting their debtor and seizing their assets. Several rules exist to establish the framework of *musharakah*. First, while the profit proportion between the two parties is negotiable, the loss is not and is fixed at the capital contribution. This ensures that the party that contributes the greater proportion of capital does not inequitably allocate the loss potential on the more minor contributor.<sup>229</sup> Profits are negotiable as a means of incentivizing two parties to join one another in a partnership that reaps the maximum reward for both. The profit ratio can be adjusted to account for unequal labor expenditure and the experience or education of the partners.<sup>230</sup>

Of the Islamic finance tools mentioned thus far, income share agreements find their closest analogue in *musharakah*. *Musharakah* intertwines the success of two contracting parties and allows for a significant upside potential for both with a fixed loss. Income share agreements similarly promise such a win-lose arrangement. In an income share agreement, both parties succeed together as the student's income increases whereas the loss is fixed to the capital contributed by the investor. A student's loss is not correlated to an investor's efforts nor is the student permanently indebted to an investor the way a borrower, thanks to interest, can very easily find themselves permanently indebted to a bank. Unlike income share agreements, however, *musharakah* requires at least some capital expenditure between both parties and while *musharakah* is an appropriate vehicle for financing a commercial endeavor, there exists

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<sup>229</sup> Almir Colan, "Musharaka (Equity Partnerships)" (An Introduction to Islamic Finance with Almir Colan, 2016).

<sup>230</sup> Ibid.

a significant distinction between commercial and educational financing. More appropriate analogues exist within Islamic finance.

### Sukuk

On an international scale, *sukuk*, a form of Islamic bond, is the most widely known form of Islamic finance. Saudi Arabia has recently announced its sale of over \$9 billion worth of *sukuk*<sup>231</sup> and to date, the London Stock Exchange has raised over \$50 billion through 66 *sukuk* issuances.<sup>232</sup> Other Islamic financial tools like *musharakah* and *murabaha* are not securitized nearly to the international scale as *sukuk*. The United Kingdom government, in 2014 alone, issued over £2 billion in *sukuk*.<sup>233</sup> *Sukuk* differs from conventional bonds in that, under conventional bonds, an investor is purchasing debt from a firm which the firm promises to repay plus interest. As interest is forbidden, conventional bonds are not considered *halal* (permissible). Like bonds, when a *sukuk* matures, the investor is paid back their principal. However, during the life of the Islamic bond, instead of receiving coupon payments, the investor is entitled to a portion of the profits generated from the Islamic bond's underlying asset.<sup>234</sup> These payments are

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<sup>231</sup> Carolyn Cui and Nikhil Lohade, "Saudi Arabia Raises \$9 Billion in First International Sukuk Issuance," *Wall Street Journal*, 2017, <https://www.wsj.com/articles/saudi-arabia-raises-9-billion-in-first-international-sukuk-issuance-1492022455>.

<sup>232</sup> Mondo Visione, "London Stock Exchange Welcomes Islamic Development Bank Sukuk Bond – Largest Issuance By A Supranational In 2017," *Mondo Visione*, 2017, <http://www.mondovisione.com/media-and-resources/news/london-stock-exchange-welcomes-islamic-development-bank-sukuk-bond-largest-iss/>.

<sup>233</sup> Elaine Moore and Thomas Hale, "UK Sukuk Bond Sale Attracts £2bn in Orders," *Financial Times*, 2014, <https://www.ft.com/content/7c89467e-fc4e-11e3-98b8-00144feab7de>.

<sup>234</sup> Kayali, "Sukuk on Trial."



neither assured nor are they necessarily fixed, thus differing from the interest payment of bonds. Like other forms of Islamic finance, *sukuk* involve profit sharing between the investor and the firm. For example, the coupon payments from the United Kingdom's 2014 *sukuk* issuance stem from the rents received on three government-owned properties in London.<sup>235</sup> Should the underlying asset fail, the investor will no longer receive a coupon from the use of the underlying asset. Furthermore, in the event the underlying asset appreciates, the *sukuk* investor is entitled to a greater nominal return, though the prearranged profit sharing rate remains.

In many ways, income share agreements resemble these Islamic bonds. The primary difference, of course, is that the student does not repay the principal back to the investor upon the contract's maturity date. Rather, the payment structure is such that a predetermined percentage of an individual's income is due to the investor and the principal payment is built into the repayment structure, though like *sukuk* there is no guarantee of repayment. This principal difference aside, both *sukuk* and income share agreements are investments in the productivity of an underlying asset. The more productive the asset, the greater the benefit to the investor and asset alike. Both pay back a coupon annually though some *sukuk* pay back their investors semiannually. Such a repayment time frame is not unreasonable to outline in an income share agreement as well. Like *sukuk*, there is no interest payment due to the investor and cash flows are assured by purchasing a portion of the underlying asset's future productivity. Both

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<sup>235</sup> Gemma Varriale, "UK Sukuk First Explained," *International Financial Law Review*, 2014, <http://www.iflr.com/Article/3357494/UK-sukuk-first-explained.html>.

*sukuk* and income share agreements are priced according to their risk profile, with riskier underlying assets commanding higher returns. A fundamental distinction must be made between the two, a distinction resolved with the final Islamic financial tool. *Sukuk* investors share their capital with corporations, firms, and non-human assets. Certainly, the productivity of an asset is extracted by human employees and managers, but the asset itself is not a human being. *Sukuk* investors are not investing in individuals.

### Mudarabah

A *mudarabah* contract, known as an investment partnership, exists between an investor, known as the *rabbul mal* and a manager, the *mudarib*.<sup>236</sup> The *mudarib* does not invest capital in the venture but instead invests their time and expertise.<sup>237</sup> Capital, however, is raised by the investor or investors for the venture. Almost any profit ratio is acceptable under *mudarabah* so long as it does not amount to abuse of the *mudarib*. In situations of success, the *mudarib* and *rabbul mal* split profits according to their pre-ordained agreement however, and this is crucial, in instances of loss, the financial loss is incurred solely by the investor assuming that the *mudarib* was a responsible party.<sup>238</sup> In the event of loss, the *mudarib* only loses the time and opportunity cost of entering this failed venture, but owes nothing in return to the investor. An example of *mudarabah* is the relationship between a bank and a depositor wherein a depositor entrusts their

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<sup>236</sup> Omar, "Seminar on Islamic Finance: An Overview of Shariah Contract Practice in Malaysian Islamic Banks."

<sup>237</sup> Almir Colan, "Mudaraba - Investment Partnership" (An Introduction to Islamic Finance with Almir Colan, 2016).

<sup>238</sup> Omar, "Seminar on Islamic Finance: An Overview of Shariah Contract Practice in Malaysian Islamic Banks."

money in the bank to be used wisely in some profitable venture so that the depositor earns a return. This circumvents Islam's prohibition on usury.

Of all forms of Islamic finance, income share agreements most closely adhere to *mudarabah*. In both *mudarabah* and income share agreements, an investor and manager (in this case a student) convene to issue the terms of a contract wherein the investor allocates capital to the student and in return, the student uses that investment in some productive venture, the attainment of education, which will ultimately lead to some positive cash flow, a well-paying career. Unlike *sukuk* which is an investment between an investor and a firm, *mudarabah* relies on the potential success of an individual. Among all forms of Islamic finance, there is an element of profit sharing wherein the success of the venture is distributed according to some prearranged agreement. However, with *mudarabah* and unlike *musharakah* (joint venture), the financial loss is limited to a single party and financial expenditure is required only of that single investor. Both *mudarabah* and income share agreements agree upon specific profit-sharing ratios according to the level of investment and its duration and both do not employ the use of interest or usury. *Mudarabah* contain no requirement for an indefinite relationship and thus a fixed time frame for its income share analogue does not require any preordained time frame. Of all contemporary forms of Islamic finance, income share agreements find their closest analogue in *mudarabah*.

### ***Corruption by Gharar, Maisir, and Riba***

While an analogue for income share agreements exists within the framework of *mudarabah*, this does not necessarily deem income share agreements as compliant with

*shari'ah* values. *Gharar* (uncertainty or deception), *Maisir* (get rich quick schemes), and *Riba* (usury), are all explicitly forbidden under Islamic value because they each constitute a public harm that can very easily succumb to tyranny, oppression, and cruelty. This section analyzes these three corruptors of Islamic financial contracts to make clear that none exist as inherent to income share agreements.

### Gharar

*Gharar* translated as uncertainty or deception, can first be understood according to two stories from the *Sunnah* of the Prophet. Abu Huraira, a companion of the Prophet Mohammad, in *Sunnah* tells the story that the Prophet was once strolling through a Bazaar when he noticed a pile of grain in front of a shop keeper's tent. Reaching his hand into the grain, he observed that only the top layer was dry while the grain within was wet. The shopkeeper professed he did cover the wet grain with the dry so that he could still sell his product despite a previous rain ruining some grain. In response, the Prophet commands, "you should have kept the wet grain on top of the heap so that the customer could see it; any man who cheats is not one of us."<sup>239</sup> Beyond this, the Prophet also is known to have admonished those traders who hoarded their products as a means of artificially inflating prices or those who acquire all of a city's grain in order to exert monopolistic control over a populace's staple good.<sup>240</sup>

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<sup>239</sup> Mumtaz Ahmad Faruqi, "On Buying and Selling," in *Anecdotes from the Life of the Prophet Muhammad* (Lahore: Ahmadiyya Anjuman Ishaat Islam, 1925).

<sup>240</sup> Neil Baillie, "Ihtikar, or Hoarding," in *The Moohummudan Law of Sale: According to the Huneefee Code* (London: Smith, Elder, and Co., 1850), 308–12.

These two examples position the Islamic definition of *gharar* as more than just “uncertainty” and “deception” in the way these terms are translated in English. For there exists uncertainty in all transactions and it would be irrational to assume Islamic finance abhors all uncertainty. Rather, the uncertainty of *gharar* is understood to be an excessive, intentional, and harmful form of information asymmetry that is not easily evaded. Islamic finance divides uncertainty between four classifications: inevitable, unintentional, negligible, and avoidable.<sup>241</sup> Inevitable uncertainty is something which neither seller nor buyer can reasonably foresee like, for example, the inevitability of a pair of shoes eventually wearing down so as to be unusable. Of course, one day a pair of shoes will be worn down after repeated use, an inevitability both the buyer and seller of shoes understand. Unintentional uncertainty is that which occurs if, for example, the shoe retailer sells a pair of shoes which, unbeknownst to them, contained some manufacturer defect. Negligible uncertainty accounts for unknown knowns and unknown unknowns whose possibility is so remote that they need not be taken into consideration. Should these conditions be accepted, then there exist avoidable uncertainties. All responsible buyers and sellers must perform their due diligence to ensure that a transaction does not lead to deception. A buyer of a new pair of shoes from an unknown brand should research the company or solicit a firm return policy in the event that the product does not meet their standards.

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<sup>241</sup> Almir Colan, “The Prohibition of Gharar” (An Introduction to Islamic Finance with Almir Colan, 2016).

If a seller knowingly deceives a buyer, like that of a shoe retailer knowingly selling a product to a rational buyer who cannot easily determine the product is flawed, then they are committing *gharar* and are deceiving their customer. As truth is a heavily reinforced Islamic value, transactions under Islamic law must also be completed under truthful auspices.

In addition to truth, knowledge is an important Islamic value. When engaging in a transaction, it is irrational to assume a buyer will always be an expert on the nature of the transaction. Very few automobile buyers are accomplished automobile engineers. Thus, a party to a contract cannot make it of such tremendous complexity that a lay person cannot understand its nature. The Great Recession of 2007-2009 in the United States occurred in part because mortgage lenders, investment banks, and insurance companies offered homebuyers and one another mortgage contracts or mortgage backed securities of such tremendous uncertainty as to leave multiple parties clueless of their debt obligation or equity stake. Such complexity intentionally deceived the poor and uneducated recipients of loans, as Michael Lewis wrote in *The Big Short*: “How do you make poor people feel wealthy when wages are stagnant? You give them cheap loans.”<sup>242</sup> Those “cheap loans” ended up collapsing the global economy.

Income share agreements do not suffer from neither the excessive uncertainty nor the deception conditions of *gharar*. The financial success of a student is not certain and any number of obstacles, from death to indifference, could befall a contracted

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<sup>242</sup> Michael Lewis, “A Secret Origin Story,” in *The Big Short: Inside the Doomsday Machine* (New York: W.W. Norton & Company, Inc., 2010), 14.

student and lead to a \$0.00 income-share for the investor. However, students entering income share agreements are already in college and are likely to be approaching their degree's completion. As has been noted, unemployment rates for college graduates are remarkably low with respect to their under-educated counterparts and, avoiding the inevitable uncertainty of death, the only uncertainty of a student in an income share agreement is their starting income and its growth over the contract's duration. Such uncertainties will be accounted for in all income share agreements according to the student's risk-adjusted return based on data from the career field the graduate intends on entering. This uncertainty of exact career earnings is not excessive or abusive, it is unavoidable and a part of investment risk. Furthermore, with websites like [glassdoor.com](http://glassdoor.com), [comparably.com](http://comparably.com), [linkedin.com](http://linkedin.com), [crunchbase.com](http://crunchbase.com), and the bureau of labor statistics, career earning information is widely and cheaply available. While the success of an income share agreement cannot be determined with precise certainty, its level of uncertainty is inevitable and avoidable with proper investor diligence.

Furthermore, the deception of income share agreements is markedly less than that of many other financial instruments like derivatives, swaps, options, commercial paper, currency arbitrage. These types of investments require a relatively high degree of financial literacy to properly comprehend. Conversely, the nature of an income share agreement is relatively simple, it is a contract between a student and investor wherein an investor finances a student's education in return for a prearranged percentage of their income over a prearranged duration. Certainly, there are many details to be addressed such as arrangements during non-income-sharing years, life insurance

allocations, income-sharing caps, minimum income levels, and more. But income share agreements do not create value predicated on deception or information asymmetry nor do they create value thanks to strict chance. Deception can certainly exist in the form of a student deceiving an investor by not taking a high paying job after graduation, though this is hardly likely to benefit a student and for those students whose career choices are inherently lower paying, a higher income-share ratio is likely to be negotiated in the contract. Deception can befall the student should the investor not follow through with their financing promises. Yet, such deception can easily be allayed in a contract outlining that students owe nothing to investors should the investor not fund their obligation. Still, the existence of deception is not inherent to the nature of income share agreements.

### Maisir

*Maisir* is attainment of wealth by chance and is often exemplified by gambling. The Quran notes poignantly that in gambling “is great sin and [yet, some] benefit for people.”<sup>243</sup> Despite these benefits, “their sin is greater than their benefit” and that “the excess [is beyond needs],” thus gambling is strictly haram.<sup>244</sup> Christianity similarly disdains the hasty attainment of wealthy by chance, noting in Proverbs “Wealth gained hastily will dwindle, but whoever gathers little by little will increase it.”<sup>245</sup> Among both religions is the belief that gambling produces no societal benefit and indeed can cause

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<sup>243</sup> “2:219,” in *Quran*, n.d.

<sup>244</sup> Ibid.

<sup>245</sup> “13:11,” in *Bible*, n.d.



significant harm through addiction and destruction of personal wealth. Gambling is not an isolated sin. During the Quran's revelation and up through the 21<sup>st</sup> century, communal breadwinners were men and social society was much more heavily occupied by men. Family wealth was attained by men and could be easily lost through frivolous social interaction like gambling. Meanwhile, women and children who did not have the same access to financial independence relied heavily on men. Should a man gamble away his savings or income, his family suffers, a social and familial suffering which Islamic values strictly oppose.

*Maisir* is distinct from investment. While many assert that gambling requires skill and there have been instances of significant mathematical modeling employed to “beat the casino,” like that of the famous MIT blackjack team,<sup>246</sup> gambling is still overwhelmingly susceptible to failure. No matter the strength of the mathematical modeling behind it, *maisir* endeavors are always centered on chance and produce no value to society. No information is transferred, product is manufactures, or productive service is performed; for something to be *maisir*, it must not create value for society.<sup>247</sup> Investing, while steeped in uncertainty, does not center on chance and is accomplished with the intention of producing something of value.

Income share agreements do not suffer from *maisir*. Gambling and day trading are distinct from investing because of the level of analysis involved with the former requiring none and the latter requiring it for success. A savvy investor who has studied a

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<sup>246</sup> Janet Ball, “How a Team of Students Beat the Casinos,” *BBC World Service*, 2014, <http://www.bbc.com/news/magazine-27519748>.

<sup>247</sup> Rakaan Kayali, “Understanding Maisir” (Practical Islamic Finance Podcast, 2000).

market and devised an innovative solution to a demand will reap greater success than an individual deciding to sell the first product they conjure. Conversely, the likelihood of success for an experienced gambler and an amateur are almost indistinguishable.

Deciding on an investment requires a survey of both macro and microeconomic data, as well as information relating to the firm, management, and prospects of the underlying asset itself. Gambling and day trading, meanwhile, create value through chance, speculation, or conjecture and deciding on where to gamble is simply a matter of searching for the nearest lottery-dispensing gas station. Income share agreements fall very much so into the investing category. No reasonable individual would allocate thousands of dollars to a student unless they had some prior information about that student's accomplishments, education, and ambition and should someone create an income share agreement that negates analysis of its underlying asset, then they would be engaging in *maisir* and more than likely, *gharar* (deception) as well. Inherently though, income share agreements are extremely risky to speculate over. Their rewards are over significant time horizons and require careful diligence on the part of the investor. One cannot invest in the education and future income of a student as a "get rich quick" scheme.

### Riba

Of Islamic finance's corruptors, *riba*, or usury, is the most stridently prohibited. All Islamic financial products ardently to avoid any employment of *riba*, in part because of its very clear Quranic prohibitions. The Quran states, in quite colorful language,

“Those who consume interest cannot stand [on the Day of Resurrection] except as one stands who is being beaten by Satan into insanity. That is because they say, ‘Trade is [just] like interest.’ But Allah has permitted trade and has forbidden interest.”<sup>248</sup>

Furthermore, the Quran commands “Oh you who have believed, fear Allah and give up what remains [due to you] of interest, if you should be believers,” instructing all interest awaiting entities to cancel their debts, a drastic measure matched only by the severity with which interest can paralyze debtors.<sup>249</sup> The Prophet similarly forbade *riba* with great seriousness, condemning “the receiver of interest, the payer of interest, the one who records it, and the two witnesses thereof.”<sup>250</sup> Any and all parties involved in *riba* were condemned.

Islamic finance takes umbrage in the growth of capital by natural and assured means. With any interest, a transaction occurs wherein one benefits and the other suffers. The person who benefits from *riba* does so through no productive means, the money simply grows on its own accord. Its independent growth, however, obligates a debtor to dedicate more of their capital to appease the ceaseless growth of *riba*, further miring them in debt and inhibiting their ability to positively contribute in the community by other means. Islamic banks are not concerned with the attainment of wealth by capital measures, but rather, they seek value in the productivity of goods, assets, and

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<sup>248</sup> “2:275,” in *Quran*, n.d.

<sup>249</sup> “2:278,” in *Quran*, n.d.

<sup>250</sup> Monzer Kahf, “Riba in Islamic Economics and Finance,” in *Handbook on Islam and Economic Life*, ed. Kabir Hassan and Lewis Mervin (Northampton: Edward Elgar Publishing Ltd., 2014), 135.

services which benefit the community.<sup>251</sup> The accumulation of interest in a bank does not build bridges or defend clients in courts, it simply and intangibly grows. Such intangibility is the fodder for speculative financial instruments like derivatives, options, and high frequency currency arbitrage. In the United States, there has been vast accumulation of wealth since the financial crisis, but that wealth was mostly in the form of capital gains for the highest echelons of economic society because, as one climbs down the economic ladder, stock market participation decreases significantly.<sup>252</sup> The tremendous “economic recovery,” however, has not trickled down to lower social classism breeding the type of Trump pseudo-populism that has marked the very latest United States electoral cycle. The productivity of investment, as Islamic finance sees it, should not occur naturally and intangibly, but rather, it should be intentional, deeply considered, and executed upon. Accumulation of wealth by interest in bank accounts is useless if that wealth is not productively enhancing the lives of others and instead, it simply engenders greed and corruption.

Islamic finance distinguishes between two types of *riba*, *riba al-nasiyya* and *riba al-fadl*.<sup>253</sup> *Riba al-nasiyya* is a type of interest which is incurred due to late payments or the late delivery of a contractually agreed upon good and *riba al-fadl* specifically address

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<sup>251</sup> Almir Colan, “Understanding the Different Types of Riba” (An Introduction to Islamic Finance with Almir Colan, 2016).

<sup>252</sup> Diane Swanbrow, “Stock Market Participation Has Dropped Most Among Small Investors,” *University of Michigan News*, 2014, <http://ns.umich.edu/new/releases/22365-stock-market-participation-has-dropped-most-among-small-investors>.

<sup>253</sup> Colan, “Understanding the Different Types of Riba.”

the terms of exchange between two identical products.<sup>254</sup> The latter addresses six clearly identified products called *ribawi* products. To avoid *riba al-fadl*, any exchange of any of commodities with an identical commodity must be done in equal weight. For example, a trader may trade one large sack of wheat for several smaller sacks of wheat so long as the quantities exchanged are equal. Obviously, this type of *riba* does not apply to income share agreements.

This leaves the *riba al-nasiyya* which income share agreements also do not violate. *Riba al-nasiyya* refers to interest on loans wherein, no matter the efforts to pay down the loan, interest will still grow. *Riba al-nasiyya* is also concerned with the abusive interest rates, for example those charged on credit cards for missed payments, payday loans, or check cashing stores. This type of interest, inherent to all forms of predatory financing and predatory lending, seriously harms whole communities and particularly minority communities and particularly black communities in the United States.<sup>255</sup> Interest, the darling of capitalism, does not necessarily engender maximal public good. An obvious alternative to interest is trade whose profit is sourced from markups and fees. Notice that among all tools of Islamic finance, there is an emphasis on either fees, sale for profit, or profit-sharing. Percentages may be applied to the sale of an item or to the profit-sharing ration, but not in such a way that the profit grows naturally and by its own accord. The use of fees and profit sharing evades the possibility of abusive and cruel forms of interest. Income share agreements do not use *riba* because there is no

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<sup>254</sup> Kahf, "Riba in Islamic Economics and Finance."

<sup>255</sup> Jabulani Leffal, "A Matter of Life and Debt," in *Real World Micro*, ed. Daniel Fireside, Smriti Rao, and Bryan Snyder, 15th ed. (Boston: Dollars & Sense, 2008), 36–41.

accumulating debt on the student. Should a student fail to make a payment on one year, the amount due back to their investor does not increase by a set ratio, it remains fixed. The debtor may have to add a year of repayment to supplant the foregone one, but ultimately, their net debt does not swell. Furthermore, increased payments to an investor by a student only arrive with the success of the student under an income share agreement, hardly constituting a form of abuse and in fact bettering the community by ensuring the interests of financier and recipient are alike aligned. Any income share agreement that levies financial punishments on a student for failing to pay sufficiently is by its very nature not an income share agreement but rather, a form of debt. Investors in income share agreements accept, however minute the likelihood may be, that they will not receive any return on their investment and cannot punish the student for such an outcome. It is up to the investor to perform their due diligence in ensuring that the student in whom they invest will likely generate a positive return. Should an investor compel a student in any way toward any decision in the interest of financial gain, they are in violation of *riba* and a number of other Islamic values.

### ***Income Share Agreements as a Tool of Public Good***

Income share agreements serve as a public good because they do not suffer from *gharar*, *maisir*, or *riba*. The uncertainty of an income share agreement is easily allayed by a dutiful investor, a gambler engaging in *maisir* is turned off by their long-term nature, and the instrument itself does not compel any interest payment on a student. The interests of a student and investor are aligned, with the investor profiting only when the student does as well. *Shari'ah* finance already has an instrument which

can quickly expand to accommodate income share agreements, called *mudarabah* or investment partnership, where the student, by acquiring greater education, is the *mudarib* (manager) of the investor's capital. Under a *mudarabah* contract, a specific profit ratio is decided and under an income share agreement, the profit ratio is a portion of a student's cash flow above a predetermined minimum income threshold.

The current mix of educational financing products insufficiently protects public interest. They suffer first from an inability to fully or realistically finance a student's education and second, from an excessive reliance on *riba* or interest from which students cannot attain financial independence. While an expansion of educational lending on the part of the federal government has certainly aided in greater attainment in education, it has come at a significant cost in the form of both principal and interest debt. Furthermore, the interest on the over \$1.3 trillion of student debt accumulates to benefit shareholders and financial institutions, limiting the availability of capital to be more usefully invested in communities by the students those corporations are funding. Under an income share agreement, much like under *mudarabah*, a student benefits from all of the upsides, with the financing of an education and the nonexistence of punitive debt should the labor market sour. Meanwhile, an investor benefits from the productive success of the student and, like any other investment, loses their principal should the investment fail. Unlike debt leveraging, call options, put options, or investing on the margin, should an income share agreement fall through, an investor only loses their initial investment and owes nothing extra to anyone.

Ultimately, the public benefit of income share agreements has not been properly tested. Many investors are reluctant to engage in an income share agreement due to the lack of a regulatory framework.<sup>256</sup> However, the inherent characteristics of an income share agreement make it such that a public good can be attained by their implementation and at a minimum, they structure relationships so as to minimize and eliminate any unforeseen harm. Little harm befalls a student who makes too much money thanks to their income share agreement, especially considering that their ability to attain such a high paying career relied on an investor financing their education in the first place. Should this not be acceptable, income share agreements contain provisions establishing income share caps and allowing for a student to buy out their obligations to an investor. Should they not attain their dream, high paying career, they at a minimum have an education, a college degree, and only the debt or obligation from any loans taken out aside from an income share agreement. An investor entering an income share agreement does so while conscious of the possibility that their investment may fail. These two factors combined and if applied on a macroeconomic scale, have the potential to completely transform the US economy. Investors and lenders currently do not have their interests properly synchronized to those of the individuals they serve and to the public good. This is because their profits comes directly from interest and not the productivity of the underlying asset. Income share agreements serve to realign this and

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<sup>256</sup> Palacios, Desorrento, and Kelly, "Investing in Value Sharing Risk: Financing Higher Education Through Income Share Agreements."



it is in this feature in particular that income share agreements most greatly portend a public good. Income share agreements are indeed compliant with *shari'ah* values.

## **Conclusion**

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Income share agreements have the potential to radically change the way the United States finances the education of its future generations. As Milton Friedman argued, their implementation serves as a bulwark against the rising tide of wealth inequality. If the United States is to truly reassert itself as the global superpower, we need the combined and unparalleled strength of our entire intellectual capital. We cannot change the world, as we have so frequently in the past, with just the minds of our country's elite, whose familial circumstances permit the attainment of higher education. As a country which espouses egalitarianism and abhors the depravation of life, liberty, and property, it is our duty to advocate for the attainment of education and an educated populace by any means necessary.

Income share agreements, by aligning the interests of investors with the interests of students, provide a strong shift in US economics, a shift toward a greater sense of community and social consciousness in the stead of individualistic greed. Income share agreements, better than any proposed method of wealth redistribution, allow for the accumulated wealth of the investor class to synergistically benefit those occupants of lower socioeconomic strata. By abhorring interest as a perpetual and immovable force ever indebting those unable to escape its clutches, income share

agreements allow for the maximization of student success with a minimization of potential harm.

It is for this specific reason that *shari'ah* financing is so attracted to and compatible with income share agreements. *Shari'ah* financing seeks to maximize public good and avoid harm, particularly by forbidding contracts whose value added arrives through the use of interest, gambling, or deception. In contemporary American society, the word *shari'ah* is of such tremendous horror that its mere utterance renders many immovable in fear. Yet, those same fearful individuals would just as quickly and resolutely benefit from the values *shari'ah* espouses and the children of those individuals would even more so benefit from an education funded by an income share agreement.

There is much to be done to promulgate the use of income share agreements in the United States. Currently, investor reluctance is quite high because such contracts possess no regulatory framework and are thus of impossibly high risk. Congress, should it truly care about the state and future of United States higher education, must create a regulatory framework to allow for the equitable and just execution of income share agreements. The institution of a framework for income share agreements would lead to a burgeoning income share agreement industry and inevitably, a savvy startup will use that opportunity to attract foreign investment from Muslim investors hoping to foster social good while simultaneously generating respectable returns. The same qualifications that make an income share agreement amenable to *shari'ah*-based

investment also make it attractive to socially conscious or socially responsible investors.

This creates yet another market opportunity that has thus far been untapped.

It is time for entrepreneurs and legislators to engage with income share agreements and foster their development in the United States. *Shari'ah* compliant investors are waiting. So are millions of high-potential students. Let's send them to college.

## Appendix

Table 1: Simple Income Share Agreement Model

ISA Contract Parameters											
Investment Amount	\$20,000										
ISA Term (Years)	10										
ISA Rate	5.00%										
Starting Salary <sup>257</sup>	\$50,219										
Salary Growth <sup>258</sup>	2.35%										
Nominal ISA Return											
Year	0	1	2	3	4	5	6	7	8	9	10
Income	\$50,219	\$51,399	\$52,607	\$53,843	\$55,109	\$56,404	\$57,729	\$59,086	\$60,474	\$61,895	\$63,350
Annual Payment	\$2,511	\$2,570	\$2,630	\$2,692	\$2,755	\$2,820	\$2,886	\$2,954	\$3,024	\$3,095	\$3,167
Income after ISA Payment	\$47,708	\$48,829	\$49,977	\$51,151	\$52,353	\$53,583	\$54,843	\$56,131	\$57,451	\$58,801	\$60,182
Total ISA Payment	\$31,106										
Present Value (PV) ISA Return											
Year	0	1	2	3	4	5	6	7	8	9	10
Income	\$50,219	\$51,399	\$52,607	\$53,843	\$55,109	\$56,404	\$57,729	\$59,086	\$60,474	\$61,895	\$63,350
Treasury Notes*	0.58%	0.76%	0.86%	1.01%	1.15%	1.28%	1.40%	1.45%	1.50%	1.55%	1.55%
PV Income	\$50,219	\$51,011	\$51,714	\$52,244	\$52,645	\$52,928	\$53,109	\$53,422	\$53,684	\$53,894	\$54,318
PV Annual Payment	\$2,511	\$2,551	\$2,586	\$2,612	\$2,632	\$2,646	\$2,655	\$2,671	\$2,684	\$2,695	\$2,716
PV Income After ISA Payment	\$47,708	\$48,461	\$49,128	\$49,632	\$50,013	\$50,282	\$50,453	\$50,751	\$51,000	\$51,199	\$51,603
PV Total ISA Payment	\$28,959										
ROI	55.53%										
Average Annual ROI	5.55%										
Investment Profit	\$11,106										
PV Investment Profit	\$9,522										

\*Treasury Notes given by Daily Treasury Yield Curves as of August 22, 2016.

The above model assumes an agreed upon income share agreement for an investment of \$20,000, at 5% of the student's income, over a decade. The model assumes average

<sup>257</sup> NACE Staff, "Overall Starting Salary for Class of 2015 Graduates Up 4.3 Percent," *National Association of Colleges and Employers*, 2016, <https://www.nacweb.org/job-market/compensation/overall-starting-salary-for-class-of-2015-graduates-up-4-3-percent/>.

<sup>258</sup> Economic Policy Institute, "Nominal Wage Tracker," *Economic Policy Institute*, 2017, <http://www.epi.org/nominal-wage-tracker/>.

annual salary growth of 2.35%, the average growth rate of income between 2007 and 2017. Accordingly, an investor's nominal profit is \$11,206 with a net present profit value of \$9,522. Annually, the student's payment is between \$2,511 and \$3,167 (between \$209.25 and \$263.91 per month) reflecting 5.00% of the student's income as it grows at an average annual rate of 2.35%.

*Table 2: Traditional Loan*

<b>Traditional Loan</b>	
Loan Balance	\$20,000.00
Loan Interest Rate	6.80%
Loan Fees	1.00%
Loan Term (Years)	10
Monthly Loan Payment	\$232.49
Number of Payments	120
Cumulative Payments	\$27,898
Total Interest Paid	\$7,898

The monthly payments of such an arrangement are quite comparable to a traditional loan of 6.80% under identical principal and duration parameters.

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